

TALLEY, FRENCH & KENDALL, P.C.

ATTORNEYS AT LAW
1892 Ga. Hwy. 138, S.E.
Conyers, Georgia 30013
Telephone: (770) 483-1431
Facsimile: (770) 483-4912
Real Estate Fax: (770) 929-8697
www.tfkattorneys.com

Robert E. "Mo" Talley
Laura French
Michael C. Kendall
Michelle Chaudhuri
Maureen E. Murphy
Leanne H. Messer
Mary E. Young

Douglasville Office:
3152 Golf Ridge Boulevard
Suite 201
Douglasville, Georgia 30135
Telephone: (770) 577-3559
Facsimile: (770) 577-8113

IRREVOCABLE LIFE INSURANCE TRUST

An irrevocable life insurance trust is an inter vivos trust used by an individual to remove the proceeds of an insurance policy or policies from his or her estate. The proceeds of an insurance policy will not be included in the insured's estate if it meets the following objectives: (i) the policy is not payable to the insured's estate, and (ii) the insured had no "incidents of ownership" in the policy. An insurance trust is designed to achieve both of these objectives. It is essential that the insurance trust be designated as both the owner and the beneficiary of an insurance policy. If you are obtaining a new policy to fund the insurance trust, the Trustee should apply for the policy in the name of the trust. Under current law, if an existing insurance policy is transferred to an irrevocable life insurance trust, then the insured must live for three (3) years beyond the transfer to avoid estate tax inclusion.

Payment of Yearly Premiums. Once the insurance policy is owned by an insurance trust, the Trustee of the insurance trust is responsible for making premium payments on the policy or policies. The Grantor (the person establishing the Trust) will usually give the Trustee an amount sufficient to make yearly premium payments. The Grantor cannot make the premium payments directly without inclusion in his or her estate of the policy proceeds. Therefore, the Trustee would need to establish a bank account for the trust. In order to establish the account, the Trustee will need to obtain a tax identification number from the Internal Revenue Service. Our office has applications for tax identification numbers, or you may obtain a tax identification number by contacting the Internal Revenue Service at 800-829-4933 or their website at www.irs.gov or through your certified public accountant. Once the trust account is opened, then the Grantor can make a check payable to the Trustee of the trust for payment of yearly premiums.

Gift Tax Annual Exclusions; Crummey Powers. If the Grantor gives the Trustee an amount sufficient to pay policy premiums, then the Grantor will be making a gift subject to gift tax. This year the first \$12,000.00 of gifts to each donee is not counted as a gift subject to gift tax (this is called the gift tax annual exclusion). However, this rule only applies to "present interest" gifts. A gift in trust is not a present interest gift. Therefore, the \$12,000.00 annual exclusions are not available to offset gifts to pay premiums on insurance policies held by insurance trust. Fortunately, the use of the "Crummey" powers can avoid this result. The term "Crummey" refers to the Tax Court case, Crummey v. Commissioner, which upheld the use of such powers to obtain the annual exclusion. A "Crummey" power is simply a right, exercisable by the trust beneficiaries, to withdraw property contributed to the trust. The beneficiaries are each given a

right to withdraw for a period of time (often thirty (30) days), a proportionate amount of the trust contribution. Since the beneficiaries have the right to withdraw the contribution immediately, the contribution is treated as a present interest gift. When a gift is made to the trust, the Trustee should give written notice to each of the beneficiaries. If the beneficiary is also the Trustee, no formal notice should be required. For minor beneficiaries, the minor's guardian should be notified of the withdrawal right.

The information in this memorandum is general and you should contact your tax accountant if you have any further questions.

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