



Insured/Grantor Access to Funds in an Irrevocable Life Insurance Trust

The major tax reason for making an irrevocable insurance trust (“ILIT”) the owner and beneficiary of a life insurance policy (or a split dollar interest in a life insurance policy) is to remove policy proceeds from the Insured/Grantor’s estate for estate tax purposes and, if married, to remove the policy proceeds from the Insured/Grantor’s spouse’s estate as well. In order to do so, the trust must be irrevocable. This means the Insured/Grantor cannot have the power to amend or revoke the trust and must give up all ownership interests in any insurance policy which is owned by the trust.

Below are two strategies that could provide an Insured/Grantor with access to funds from a policy that is owned by an ILIT. They are:

1. **Loans from the Trust:** This alternative exists through the use of an ILIT containing a so-called WRAP¹ feature.

This feature enables an Insured/Grantor to access trust assets (e.g., life insurance cash values) through a series of demand loans that are secured by property pledged by the Grantor/Insured with loan interest payable at a fair market rate at least equal to the amount charged as interest by the insurance company on policy loans. The loan interest in these arrangements can be paid in cash or, with sufficient collateral, accrued. The Insured/Grantor’s power to borrow using secured demand notes at fair market interest rates is similar to the right to substitute property of equal value approved by the courts in *Estate of Anders Jordahl v. Commissioner*, 65 T.C. 92 (1975), *acq.*, *action on decision*, 1977-129 (April 15, 1977).

Assuming the ILIT is a so-called “defective” trust for income tax purposes, the payment of interest to the trust should not create interest income for the trust as the Insured/Grantor and the trust are considered a single entity for income tax purposes. (IRC Sections 671, 675, IRS Reg. 1.671-2(c), and Rev. Rul. 85-13.) Obviously, the Insured/Grantor must have assets with which to secure the loans from the trust and, if such assets are present, is there any realistic need for such loans? Yes, if the assets are either illiquid (such as a home or other property) or if they have such a low cost basis that their sale would trigger extensive capital gains taxes. In either of these cases, loans from the trust could be welcome indeed.

There is no direct authority considering the use of a Wrap trust, and its suitability for a particular client must be determined by legal and tax advisers on a case-by-case basis; however, even very conservative clients may wish to include the language in their trusts in case the feature becomes desirable at a later date.

¹ James G. Blase, JD, LLM, of St. Louis, Missouri, has trademarked the Wealth, Retirement, and Asset Protection (WRAP) Trust.

2. Successor Trust: Access to funds in trust could be accomplished if the trust has a provision naming a limited power holder who has the right to move trust assets (or some of the assets) to a successor trust. If the limited power holder so chooses, the successor trust could have provisions to provide for the support of the Insured/Grantor. The successor trust might even be a *revocable* life insurance trust. In either case the Insured/Grantor could have access to the trust's assets. With either approach, any subsequent policy death benefits would undoubtedly be included in the Insured/Grantor's estate; however, this is hardly an issue if the Insured/Grantor is in need of funds later in life, or if estate taxes are ultimately repealed and the irrevocable trust no longer makes sense.

Due to potential coercion issues, a limited power holder should not be an employee of the Insured/Grantor or an employee of any entity controlled by the Insured/Grantor.

Counsel may wish to add successor limited power holders in the event a single limited power holder is deceased or otherwise unable to act. Counsel may also wish to provide for multiple limited power holders in which two (or more) must concur. Alternatively, counsel may wish to include multiple limited power holders in which *any one* may exercise the power granted.

Note: The suitability of the limited power holder strategy for a particular client must be determined by legal and tax advisers on a case-by-case basis; however, even very conservative clients may wish to include the language in their trusts in case the feature becomes desirable at a later date. There is no specific tax authority for delegating these powers to a limited power holder in an irrevocable trust. If the technique appears useful to a client, *be certain that the client's legal and tax advisers agree that its inclusion does not contaminate the estate tax free nature of the irrevocable trust from the inception of the trust.*

Specimen Documents: Specimen wording for Wrap trusts and several variations of limited power holders is included in InsMark's Cloud-Based Documents On A Disk™ in a series of specimen trusts called Ultimate Irrevocable Life Insurance Trusts (ULITs). See the Family Trust category. For information about licensing [Documents On A Disk](#), call 888-InsMark (467-6275).

[Click here](#) to review Highlights of the Plan of one of the ULIT trusts used with survivor life policies.

Important Notice

The information in this article is for educational purposes only. In all cases, the approval of a client's legal and tax advisers must be secured regarding the implementation or modification of any planning technique as well as the applicability and consequences of new cases, rulings, or legislation upon existing or impending plans.