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**Lidia Carr Law Offices, LLC**  
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## **Keeping Life Insurance Out of Your Estate**

Many individuals ask how to make sure the life insurance benefits their family will receive after their death avoid the federal estate tax. This is an important issue because, once the federal estate tax applies (for federal estates over \$3.5 million in 2009 and over \$1 million in 2011), the rates are high (the top rate is 45% in 2009 and 55% in 2011).

Insurance on your life will be included in your federal estate if either:

- (1) Your estate is the beneficiary of the insurance proceeds, or
- (2) You possessed certain economic ownership rights ("incidents of ownership") in the insurance policy at your death (or within three years of your death).

To avoid the first situation you need to make sure to designate someone other than your estate as primary and contingent beneficiaries of your insurance policy.

The second situation is more complex. Clearly, if you are the owner of the insurance policy, the proceeds are included in your federal estate regardless of who the beneficiary is. However, simply having someone else possess legal title to the policy will not prevent this result if you keep so-called "incidents of ownership" in the insurance policy. Rights that, if held by you, will cause the proceeds of your insurance policy to be included in your federal estate include:

- ... the right to change beneficiaries,
- ... the right to assign the policy (or to revoke an assignment),
- ... the right to pledge the policy as security for a loan,
- ... the right to borrow against the policy's cash surrender value, and

... the right to surrender or cancel the policy

Keep in mind that merely *having* any of the above powers will cause the life insurance proceeds to be included in your federal estate even if you never exercise the power.

### **Life Insurance Trusts**

A life insurance trust is an effective vehicle that can be set up to keep life insurance proceeds from being included in the insured's federal estate. Typically, the policy is transferred to the trust along with assets that can be used to pay future premiums. Alternatively, the trust buys the insurance itself with funds contributed by the insured. As long as the trust agreement gives the insured none of the ownership rights described above, the proceeds will not be included in the insured's federal estate.

### **The Three Year Rule**

If you are considering setting up a life insurance trust with a life insurance policy you own currently or simply assigning away your ownership rights in such a policy, please effect these moves as soon as you reasonably can. Unless you live for at least three years after these steps are taken, the proceeds will be included in your federal estate. For policies in which you never held incidents of ownership, the three-year rule does not apply.

### **IRS Circular 230 Notice**

To the extent that this message, and/or any attachments, concern tax matters, they are not intended to be used and cannot be used by you for the purposes of avoiding penalties that may be imposed by law.