John Hancock

LIFE INSURANCE

Success Strategy

Basics of Irrevocable Life Insurance Trusts (ILITs)

An Irrevocable Life Insurance Trust (ILIT) is a time-honored vehicle for estate planners. Estate planning lawyers have been drafting ILITs for years, using the power of life insurance to leverage gift tax exemptions. An ILIT can provide both tax and non-tax advantages that are not available with outright policy ownership by an individual.

WHAT IS AN ILIT?

An ILIT is an irrevocable trust created to own life insurance. The ILIT is both the owner and the beneficiary of one or more life insurance policies, typically insuring the life of the person or persons creating the ILIT, known as the grantor. If the trust is structured properly, life insurance proceeds received by an ILIT will not be subject to income tax or estate tax upon the death of the insured or the insured's spouse.[1]

HOW DOES IT WORK?

You are allowed to make "present interest" gifts of up to $13,000 per person each year without having to pay gift taxes. This type of gift is called an "annual exclusion gift," and you can make as many annual exclusion gifts to as many people as you like in any given year, free of gift tax.[2] You can use annual exclusion gifts (as well as the $1,000,000 lifetime gift exemption) to fund an Irrevocable Life Insurance Trust (ILIT).[3] The ILIT can use the gifts to purchase a life insurance policy, potentially increasing the amount left for your heirs.

There are a variety of different ILITs that can be used in estate planning, depending on your needs and preferences, including: **Spousal Access Trusts** (a trust for the benefit of spouse and children), **Dynasty Trusts** (multi-generational trusts), **Leveraged Credit Shelter Trusts** (a bypass trust can purchase life insurance or make a loan to an ILIT to purchase life insurance) and **Grantor Trusts** (a type of ILIT that is funded with income-producing assets in addition to life insurance).

BENEFITS

- Funding an ILIT with lifetime gifts can help reduce the size of your taxable estate.
- ILITs provide liquidity, outside of the insured's taxable estate, for the payment of estate taxes, debts and expenses of administration.
- ILITs can protect assets from creditors of the beneficiaries, avoid probate for gifted assets and protect your family's privacy.[4]
- ILITs can provide for the effective management of insurance proceeds and increase the amount of money left for your heirs.
- ILITs can enable you to equalize inheritances when you would like to pass a single asset (such as a family business or farm) to one child, yet leave equal value to other children.

CONSIDERATIONS

- Transfers of assets to an ILIT are irrevocable, and once given, may only be used for the benefit of the trust beneficiaries.
- Taking policy loans and withdrawals from a life insurance policy during the insured's lifetime can reduce the available death benefit and cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to income tax when a loan or withdrawal is made, and a federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½. Cash value available for loans and withdrawals may be more or less than originally invested.

CASE STUDY: SEAN AND KELLEY MACCAULEY

Sean and Kelley MacCauley are both age 55 and have three children. Their estate is currently worth $10,000,000 and is growing at an after-tax rate of 4% a year. Their financial planner recommends that the MacCauleys establish an ILIT and fund it with their annual exclusion gifts. He shows them three different scenarios: (1) doing nothing, (2) gifting to a trust and investing, and (3) gifting to a trust and purchasing life insurance. For the life insurance scenario, the MacCauleys will purchase a John Hancock Protection Survivorship UL-G 10 policy with a face amount of $6,736,968 and an annual premium of $52,000.[5]

Comparison of Benefits in Year 30	Scenario 1 No Gifting	Scenario 2 Lifetime Gifts to an Irrevocable Trust and Investing at 6%	Scenario 3 Lifetime Gifts to an Irrevocable Trust with Life Insurance
Cumulative Gifts Years 1–30	$0	$2,301,000	**$2,301,000**
Total Estate Value	$31,393,975	$26,884,925	**$26,884,925**
Estate Taxes Due	$16,920,886	$14,440,909	**$14,440,909**
Assets in Trust	$0	$6,495,191	**$8,874,472**
Net to Heirs	$15,473,089	$19,939,207	**$22,318,488**

Insurance data shown is taken from an illustration. Non-insurance data shown is taken from a hypothetical calculation. It assumes a hypothetical interest crediting rate and may not be used to project or predict investment results.

As the above chart indicates, by giving to an ILIT and purchasing life insurance, the MacCauleys can reduce their expected estate tax liability and significantly increase the amount to their heirs, over $2 million more than if they gifted to a trust and invested the proceeds, and over $6 million more than doing no gifting at all.

This material does not constitute tax, legal or accounting advice and neither John Hancock nor any of its agents, employees or registered representatives are in the business of offering such advice. It was not intended or written for use and cannot be used by any taxpayer for the purpose of avoiding any IRS penalty. It was written to support the marketing of the transactions or topics it addresses. Comments on taxation are based on John Hancock's understanding of current tax law, which is subject to change. Anyone interested in these transactions or topics should seek advice based on his or her particular circumstances from independent professional advisors.

1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. Gifts to a trust may qualify for the annual exclusion if they are "present interest gifts" and the trust beneficiaries have "Crummey" rights of withdrawal over the gifts.
3. The annual exclusion will be indexed for inflation in $1,000 increments based on increases in the Consumer Price Index (CPI). The lifetime gift exemption is set at $1,000,000 and is not expected to change.
4. Assuming the proposed initial gift was not a fraudulent conveyance meant to inhibit creditors.
5. Based on Male, Preferred Non Smoker, age 55 and Female, Preferred Non Smoker, age 55, California residents, full-pay policy. At the guaranteed crediting rate of 3.00% and guaranteed policy charges, the policy could be kept in force until year 67 with an annual premium of $52,000 for all years.

Insurance policies and/or associated riders and features may not be available in all states. Guaranteed product features are dependent upon minimum premium requirements and the claims-paying ability of the issuer.

Insurance products are issued by John Hancock Life Insurance Company (U.S.A.), 197 Clarendon Street, Boston, MA 02116 (not licensed in New York), and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

IM1455 04/10 MLINY04051012647

Policy Form: 10PROSULG

INSURANCE PRODUCTS:		
Not FDIC Insured	Not Bank Guaranteed	May Lose Value
Not a Deposit	Not Insured by Any Government Agency	

John Hancock
the future is yours®