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House Bill Proposal May Reshape Insurance Trusts, Here are the Steps to Plan Ahead

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On September 13, 2021, the House Ways and Means Committee Chairman Richard Neal introduced the Committee's proposed budget tax provisions. One of the proposed provisions would tighten the rules applicable to grantor trusts, potentially pulling grantor trusts into a decedent's taxable estate when the decedent is the deemed owner of the trust.

The proposed changes would apply to grantor trusts created on or after the date of enactment of the legislation and to existing grantor trusts with contributions made on or after the date of enactment. As such, these new rules could potentially impact existing Irrevocable Life Insurance Trusts (ILITs).

Traditionally, ILITs have been structured as grantor trusts, often funded with gifts made on an annual basis, using annual exclusion/Crummey gifts for the purpose of the premium payment.

Under the proposed legislation, gifts after enactment to grandfathered grantor trusts would be at least partially subject to estate tax. Therefore, a portion of the life insurance proceeds could be included in the grantor's taxable estate.

If these provisions go into effect, many clients will need to reassess their estate plan, existing ILITs, and funding options before and after the date of enactment. Several factors should be reviewed closely, including the size of the estate, trust provisions, the client's age and health, and the underlying life insurance policy.

For existing grantor ILITs with ongoing premiums, some common considerations and solutions could include:

- Large gifts of cash or income-producing property before the date of enactment.
- Policy flexibility. Many modern life insurance policies, particularly Universal Life contracts, offer a flexible premium and flexible death benefit. Review options to advance premiums or consider reducing the death benefit to lower/eliminate ongoing premiums.
- Review if an exchange of the current policy for one that requires no further premiums is possible.
- Private premium financing, whereby the grantor lends the funds to the ILIT for future premium payments.
- Review if grantor trust powers can be "toggled off" before the enactment date.
- Review if the ILIT can distribute the policy to beneficiaries.

Given the uncertainty and potentially limited window of opportunity to plan, it is recommended for clients and planners to review existing strategies and build flexibility into plans wherever possible. We recommend a thorough review to gather information on existing policies and fashion funding options suitable for grantors.

While beyond the scope of this article, other components of the House Ways and Means proposal may increase the need to have discussions around the benefits of life insurance, as well. In particular, when exemptions are lower or if there are concerns about estate tax inclusion, there is likely an increased need for liquidity to pay estate taxes for many families.

For new ILITs and life insurance planning, consider if a non-grantor trust would be suitable. In this arrangement, future premium gifts should be cash gifts only. While some flexibility may be lost compared to the previously common grantor trust arrangement, this could be an acceptable solution for any ILIT strategy that only plans to hold the life insurance policy as a permanent asset. Alternatively, some families may prefer to have the beneficiaries own the life insurance policy outright.

As a final note, it's likely that ILITs were not an intended target of the proposed grantor trust changes, and these provisions are a top priority for the life insurance industry in discussions with legislators and congressional staffers. Many believe that the grantor trust proposals are likely to be adjusted, particularly as it relates to ILIT planning. More clarity should be provided in the coming weeks. Still, in the meantime, clients and planners should gather sufficient information on existing plans and prepare options that can be acted upon quickly if needed.

Review your trust with your advisor now to make adjustments to your plan and to ensure you're prepared.

About the Author

Adam C. Hyser provides quality, unbiased, third-party technical support in financial and insurance planning. He is responsible for guiding the risk management and insurance decision-making process for high-net-worth individuals, business owners, and families across the country.

Before joining Key Private Bank, Adam served as a consultant to more than 40 advisors in 18 states. Also notable is his tenure as Director of Insurance Services for one of the premier insurance advisory firms in the nation.

Adam earned his bachelor's degree in Financial Services from the University of Akron, where he graduated summa cum laude. He holds his life, health, and variable annuity licenses in multiple states. In addition, he holds his Series 7, 63, and 24 licenses, making him a registered principal.

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