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assets

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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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Alphabet Soup: ILITs and the GST

With Federal estate taxes designed to tax assets transferred from one estate to another, planning to preserve wealth for your children, grandchildren, and future generations can be challenging. In 2017, the Federal estate and gift tax rates are as high as 40%; therefore, wealthy individuals, as well as those of modest means, need to carefully formulate their financial and estate plans in order to help ***minimize*** taxes and ***maximize*** their financial legacies. As a result, the **irrevocable life insurance trust (ILIT)** has become recognized as a straightforward mechanism for funding future estate tax liabilities and creating the potential for leveraged gifts to family or charity. However, in such cases, estate planners should also be aware of the implications of **generation-skipping transfer (GST) taxes** and take special care to ensure this additional transfer tax is not incurred.

Annual gifts by a donor to an ILIT are typically used to make premium payments on a life insurance policy insuring the life of the donor(s). The size of the gift will determine the amount of insurance the ILIT will be able to purchase. Thus, it is not uncommon for grandchildren to be included as ILIT beneficiaries in order to maximize the use of the donor's **annual gift exclusion** ($14,000 annually per donee and $28,000 for gifts made by a married couple) and Crummey withdrawal powers.[1] The proceeds of a properly executed ILIT will not be included in the estate of the donor(s).

The GST tax is an additional tax imposed on all transfers (during one's lifetime or at death), either outright or in trust, to a skip person, when the transferred assets are not subject to gift or estate taxes in the gross estate of the skipped generation. A skip person is an individual at least two generations removed from the generation of the transferor. For example, if a grandparent is a transferor, a grandchild qualifies as a skip person. The GST tax rate is currently equal to the maximum 40% Federal estate tax rate and is applied to the entire transferred amount. However, every individual has a **generation-skipping exemption** ($5.49 million in 2017) for transfers while living, as well as those at death; the generation-skipping exemption cannot be transferred between spouses.

It should be noted that the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) has amended the GST tax exemption amount in any calendar year to equal the estate tax applicable exclusion amount in effect for that calendar year.

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