13

Coordination Of ILIT With Insured's Other Estate Planning Documents

CHAPTER OVERVIEW

An ILIT is an adjunct to the grantor's base estate planning documents.[1] This chapter discusses which key base estate planning documents need to be coordinated with the ILIT to ensure the ILIT's efficacy and survivability, especially if the grantor becomes physically or mentally incapacitated. Sample drafting language for durable powers of attorney is also provided.

§13.1 COORDINATE ILIT WITH INSURED'S REVOCABLE LIVING TRUST AND WILL

If the insured transfers to the ILIT existing life insurance policies that insure only the grantor's life, then not only should a contingent marital trust provision be inserted in the ILIT (if the insured is married), but also the tax apportionment clauses in the insured's will and revocable living trust (if applicable) should be coordinated and should deal

---

[1] Because an ILIT is an adjunct to a person's base estate plan, an ILIT should not be used as a pour-over from a person's estate, will, or other trust. Drafting of coordinated base estate planning documents, such as a revocable living trust, pour-over will, durable power of attorney, and health care declaration is beyond the scope of this book. *See generally*, Sebastian V. Grassi, Jr., *A Practical Guide to Drafting Marital Deduction Trusts (with Sample Forms and Checklists)*, ALI-ABA, Philadelphia, PA (2004, Supp. 2006) (800) 253-6397, http://www.ali-aba.org/aliaba/bk36.asp.

with the contingency concerning the payment of death taxes on the life insurance policy. In the absence of such a provision, IRC section 2206 states that the beneficiaries of the insurance proceeds are to pay their pro rata share of death taxes. Additionally, if a contingent marital trust provision is used, the tax apportionment provisions in the surviving spouse's will must be coordinated to insure consistency with the grantor's overall intent. Even without a surviving spouse, the tax apportionment provisions should be coordinated in the grantor's estate planning documents, since it is unlikely that all of the insured's estate planning documents are going to have identical devisees/beneficiaries and identical dispositive provisions.

For example, what if the life insurance proceeds are includable in a married insured's gross estate and the ILIT has a zero GST tax inclusion ratio? Fortunately, the ILIT proceeds can be paid to a QTIP marital deduction trust and the existing GST tax inclusion ratio can be preserved by having the insured's executor make an IRC section 2652(a)(3) reverse QTIP election as to the whole marital deduction trust (to preserve the insured's previously allocated GST tax exemption). The insured's spouse's will should provide that the right to recover estate taxes under IRC section 2207A (concerning QTIP trust property) is waived and the estate tax is to be apportioned (without the right to recovery or contribution from the QTIP trust property or the recipients of the QTIP trust property) against the residue of the surviving spouse's estate. Be careful with this formulation, however, particularly if the surviving spouse is a second spouse and there are children from different marriages involved.

§13.2 COORDINATE ILIT WITH INSURED'S DURABLE POWER OF ATTORNEY

The insured's durable power of attorney for financial affairs should contain gifting provisions and permit the attorney-in-fact to make irrevocable gifts and transfers directly to beneficiaries and to any irrevocable trust that has been established by the insured. This provision insures that if the insured is incapacitated, the trust can continue to be funded, and thus prevents a potential lapse of the insurance policies. Absent the agent's express authority to make gifts under the durable power of attorney (or applicable state law), the gifts to the ILIT will be challenged by the IRS as being revocable by the insured, and subject to inclusion in the insured's gross estate under IRC section 2038. *See,* *e.g.*, *Estate of Casey v. Commissioner*, 948 F.2d 895 (4th Cir. 1991); *Estate of Mary Catherine IX Gaynor v. Commissioner*, T.C. Memo 2001-206 (2001); TAMs 9342003 and 9736004.

Drafting Example:

Gifts-Restricted Amount. *My Agent is authorized to make irrevocable gifts that are eligible for exclusion under Internal Revenue Code sections 2503(b) or 2503(e) (concerning direct payment of tuition and/or medical care) as my Agent deems proper, with any of my real estate or personal property, to or for: my spouse (if I am married), any of my descendants (and their spouses), any of my relatives, or any persons who are listed as beneficiaries or devisees (present or contingent) under my will or any trust created by me (and not my Agent), or any charitable organization (including gifts to complete or fulfill a charitable pledge made by me). Any gifts my Agent may make to him or herself as a permissible donee hereunder without the consent of a person who has a substantial adverse interest vis-à-vis my Agent regarding any gifts made from my property shall be limited by an ascertainable standard related to my Agent's health, education, support, and maintenance; provided however, my Agent may make gifts to him or herself not subject to an ascertainable standard (but subject to any other limitations imposed by the provisions of this paragraph) with the prior written consent of a person who has a substantial adverse interest vis-à-vis my Agent regarding any gifts made from my property. My Agent may not make gifts to my Agent's creditors or make gifts that would discharge my Agent's legal obligation of support. Except for qualified transfers under section 2503(e), and gifts to qualified state tuition programs under section 529, no gifts to any individual in a calendar year shall exceed the amount eligible for the annual federal gift tax exclusion under section 2503(b), or twice that amount if I am married and my spouse is a resident or citizen of the United States; provided however, gifts to my spouse (if I am married) shall not be limited to the amount of the annual federal gift tax exclusion, but rather, shall be limited to the amount qualifying for the federal gift tax marital deduction. Gifts to any charitable organization shall be deductible under Internal Revenue Code sections 170 and 2522 in the year in which such gifts are made, and shall not exceed the amount that I can deduct: (i) in the year in which the gift is made and (ii) in any available carry forward years. All such gifts may be made outright, in trust, to a trust (including an irrevocable trust I have created or shall create at any time), or to any legal guardian or custodian under any applicable Uniform Transfers (or Gifts) to Minors Act, as my Agent deems appropriate, even if my Agent is such trustee, guardian, or custodi-*