The Spousal Support Trust As A Hedge Against Estate Tax Uncertainty

With the excitement surrounding legislation for estate tax repeal, many clients have been reluctant to purchase life insurance in an irrevocable life insurance trust (ILIT). The issue of estate tax repeal in conjunction with a client's desire to have the flexibility of using the life insurance cash values to help supplement their retirement income (in addition to its primary benefit of providing death benefit protection) or provide support for the surviving spouse, may make the Spousal Support Trust (SST) a good alternative.

Facts: Assume your clients have a net worth of approximately $4,500,000 consisting of mostly low income producing assets. The husband is the sole income provider. Your analysis determines that there is a need for coverage on the husband to provide the surviving spouse with income. In addition, because of the potential growth of the value of the estate and because the estate tax exemption increases gradually, there may be a need for estate liquidity. The clients understand that insurance purchased in an ILIT can provide estate tax-free liquidity; however, they are hesitant about using an ILIT because of a concern that they may need to access the cash values to help supplement their retirement income. An SST may be the solution to meet all their objectives. The following is how the concept works.

Solution: A Spousal Support Trust is simply an irrevocable life insurance trust with provisions that allow the trustee to make distributions to the insured's spouse and children, if needed. Generally, the spouse with the longest life expectancy (assumed to be the wife for purposes of this presentation) is the trust beneficiary and the other spouse the insured.

The husband creates a trust, with the assistance of his attorney and advisors, and makes annual gifts to it. All gifts to the trust must be from the husband. If he lives in a community property state, he must use separate property to make the gifts. The trustee of the trust uses the gifts to purchase life insurance on the husband.

During the husband's lifetime, the trustee has the discretionary power to make distributions to the spouse and/or children for health, education, maintenance, and support. This flexibility allows the spouse to use policy cash values to provide supplemental income. This income can be received income tax-free if the trustee withdraws policy values to the extent of basis and then utilizes loans from the policy for the distributions.[1]

If the life insurance is maintained until the husband's death, the trust will receive the death benefit free from both income (under IRC §101(a)) and estate taxes. Furthermore, at the surviving spouse's death the trust assets will not be included in her estate because she has only a discretionary interest in the principal.

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- Target Term Rider giving you the flexibility to help meet your clients' premium limitation caused by gift tax annual exclusion or to help offset a premium increase caused by an unexpected table rating;
- Compensation that is not reduced because of your client's age or impairment.

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[1] Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans and withdrawals reduce policy cash values and death benefit, may affect any policy guarantees against lapse, and may have tax consequences.
[2] All guarantees are based on the claims-paying ability of the issuer.

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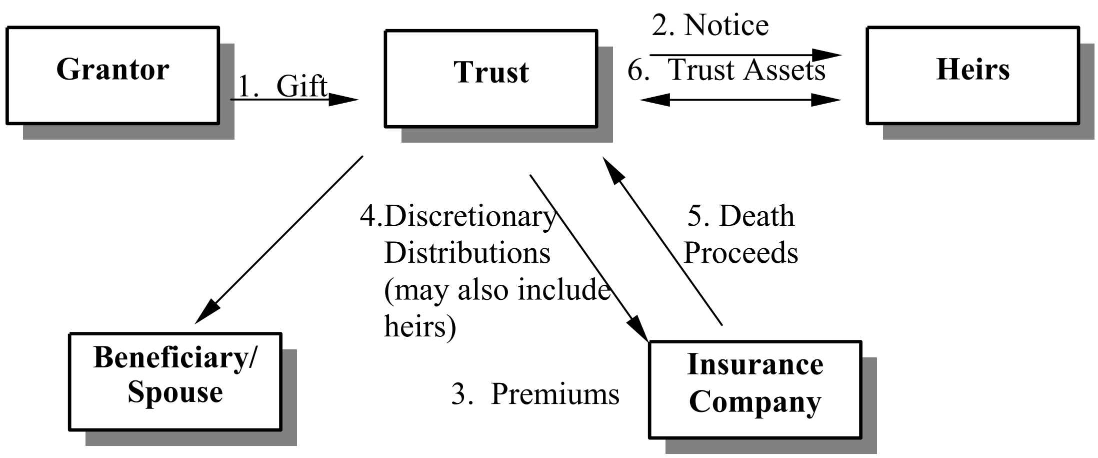
Structure of the Spousal Support Trust



1. Grantor (insured spouse) makes gifts of separate property to an SST/ILIT to fund the payment of policy premiums. The non-insured spouse (beneficiary spouse) is the beneficiary of the trust with access to both income and principal of the trust.

2. The trustee notifies the trust beneficiaries of the gift pursuant to the Crummey withdrawal provision in the trust document. (The beneficiary spouse can be trustee. However, the trustee powers should be reviewed with the client's attorney/advisor to make sure they don't result in trust assets being included in the spouse's estate. Typically, this means the trust should prohibit distributions to the spouse in excess of health, education, maintenance and support.)

3. If the beneficiaries fail to exercise the withdrawal right, the trustee may use the gift to pay premiums for the life insurance policy on the insured spouse's life.

4. During the lifetime of the beneficiary spouse the trustee can invade the trust for the benefit of the beneficiary spouse and other beneficiaries as permitted by the trust.[3]

5. At the insured spouse's death, the insurance company pays death proceeds to the trust which are used to provide for the beneficiary spouse during his or her lifetime.

6. At the beneficiary spouse's death, the trust functions like a traditional ILIT. The trust assets pass estate tax-free to the heirs.

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