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Life insurance lessons from a 'Sopranos' star

James Gandolfini has been gracing the headlines over the past few months.

Surprisingly, the publicity surrounding the late television star's death is not focused on his award-winning performance in "The Sopranos" or a Hollywood scandal — but rather his estate planning.

Tony Soprano certainly missed some extraordinary estate planning opportunities.

His will left 80 percent of his $70 million estate to his sisters and his daughter, subject to estate taxes at a rate of approximately 55 percent.

In contrast, Gandolfini's life insurance was properly structured. Namely, the owner and beneficiary of his $7 million life insurance policy was an irrevocable life insurance trust (ILIT) for the benefit of his son, which passed free of income and estate taxes.

Life insurance is an incredibly flexible and effective estate planning tool and can provide for myriad situations, including:

- Supporting loved ones after one's passing
- Investment purposes
- Funding corporate buy-sell agreements
- Divorce settlements
- Estate tax replacement

Clients are strongly encouraged to have their policies reviewed every few years. With life expectancies increasing, the IRS released new mortality tables in 2013, which caused the pricing on life insurance to decrease dramatically. Similar to refinancing a mortgage, this decrease in rates has allowed many clients with existing policies to purchase new policies that offer the same coverage with lower premiums.

Avoid probate: Life insurance policies always carry a beneficiary designation, which allows the proceeds from the policy to pass by operation of law to the designated beneficiaries and avoid probate. By circumventing probate, this saves expenses in estate administration, allows the beneficiaries to have immediate access to the funds and keeps matters private.

Asset protection for cash value and death proceeds: The accumulated cash value in a policy during the insured's lifetime and the death proceeds can be asset-protected, depending on who the designated beneficiaries are. Prior to August 2012, 735 ILCS Section 5/12-1001 protected from judgment or attachment "all proceeds payable because of the death of the insured and the aggregate cash value of any and all life insurance and endowment policies and annuity contracts payable to a wife or husband of the insured or to a child, parent or other person dependent on the insured." 2007 Ill.Legis.Serv. P.A. 95-306 (West).

Previously, the policy had to directly name a spouse, child or dependent as the designated beneficiary. The 1st District Illinois Appellate Court interpreted this provision strictly in *Dowling v. Chicago Options Associates Inc.* when it refused to apply it to a father's life insurance policy where he named an irrevocable trust for the benefit of his children as the beneficiary. *Dowling v. Chicago Options Assoc.*, 365 Ill.App.3d 341 (1st Dist. 2006).

In response to Dowling, the Illinois legislature amended Section 5/12-1001 in August 2012 to add revocable and irrevocable trusts for the benefit of children, spouses or dependents to the list of protected property under the statute. 735 ILCS Section 5/12-1001 (2012).

In light of this recent legislation, clients are encouraged to designate their revocable living trusts or ILITs (instead of individual family members) as the beneficiary of their life insurance policies. Benefits of listing a trust as the beneficiary of a life insurance policy include:

THE BUZZ

Lindsey Paige Markus

Lindsey Paige Markus, a principal at Chuhak & Tecson P.C., draws on her early career in business, finance and clinically applied neuroscience to communicate with clients and develop creative solutions to fit their estate planning and asset protection needs. Lindsey was named an Illinois Super Lawyers Rising Star in 2010, 2011 and 2012. She is licensed in Illinois and Florida.

- Proceeds pass to the beneficiaries in the most tax-efficient fashion
- Assets protected with respect to the beneficiary's creditors
- Safeguard mechanisms for proceeds payable to minor children

Irrevocable life insurance trusts (ILITs): Many clients fail to recognize the estate tax implications associated with life insurance policies. When an insured is the owner of an insurance policy, the insured is said to have "incidences of ownership" and the full value of the proceeds from the life insurance policy are included in his or her gross estate upon death (not just the face value or cash value of the policy during a lifetime). 26 U.S.C. Section 2042.

For example, a term insurance policy with no cash value and a $3 million death benefit will cause $3 million to be included in the decedent's taxable gross estate. Thus, although the estate tax exemptions are currently high ($5.25 million at the federal level and $4 million at the Illinois level), even clients with modest net worth but sizable insurance policies can find themselves with a taxable gross estate.

An ILIT is an estate-planning vehicle created for the principal purpose of owning a life insurance policy (or policies). When properly structured and maintained, the ILIT is the owner and beneficiary of the policy which allows death benefits paid to the trust to be excluded from the insured's taxable gross estate, potentially saving millions of dollars in estate taxes.

If a policy is applied for and purchased in the name of the ILIT from inception, the insured has no "incidences of ownership" and it can pass income and estate tax free to the beneficiaries upon death. If an existing policy is transferred to an ILIT as a gift, it is subject to a three-year look-back rule. However, the look-back period can be avoided if the transfer is structured as a sale.

Unlike revocable living trusts, ILITs require additional maintenance:

- Federal Tax Identification Number
- Separate bank account
- Premium payments made are considered "gifts" to the beneficiaries of the ILIT
- "Crummey" letter must be sent every calendar year to each of the beneficiaries of the ILIT informing each beneficiary of his/her right to withdraw the gift within a certain time period

The additional maintenance for an ILIT is nominal relative to the potential estate tax savings. Consider having your existing policies reviewed to make sure you are maximizing your investments.

And make certain the ownership and beneficiary designations on your policies are properly titled to ensure maximum estate planning and asset protection.

Take a lesson from Gandolfini and let's avoid a "Sopranos" situation.

Thanks to Chuhak & Tecson P.C. law clerk Evan Blewett for his contribution to this column.