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Dear Client:

Pursuant to your estate plan, we have drafted and executed an Irrevocable Life Insurance Trust (the "Trust").

It is important that the Trust be properly operated. In furtherance of this endeavor, the Trust must be the owner and beneficiary of the Life Insurance issued on the insured's life. Therefore, it is important that any new insurance policies be issued directly to this Trust and that the ownership of existing insurance policies be properly transferred into the Trust. Generally, your insurance agent will help you transfer the policies.

Moreover, once the Trustees of the Trust receive any payments, it is imperative that the Trustees send out "Crummey Notice" letters to all of the beneficiaries of the Trust. A sample of the Crummey Letter can be found at the last page of the outline referenced below.

This letter shall serve as confirmation that we discussed the operation of the Trust and that you will monitor same to insure that the Trust is properly utilized. Kindly sign the signature line below acknowledging your receipt of this letter.

Lastly, we have given you an outline entitled "Irrevocable Life Insurance Trusts: Life Insurance and its Interrelationship with Estate Planning" which includes a checklist of steps to be followed to properly operate the Trust as well as the sample Crummey Letter.

If you have any questions pertaining to the above, please do not hesitate to contact us.

Very truly yours,

Karol Hausman & Sosnik, P.C.

The undersigned acknowledges that he/she has read and understands the above.

Acknowledgment

Date

**IRREVOCABLE LIFE INSURANCE TRUSTS:
LIFE INSURANCE AND ITS INTERRELATIONSHIP
WITH ESTATE PLANNING**

I. INTRODUCTION

This Summary and the attached Checklist is presented to allow you to understand the importance and operation of an Irrevocable Life Insurance Trust.

It is our belief that the Irrevocable Life Insurance Trust is one of the best estate planning tools permitted under current tax law. An inter-vivos (lifetime) Irrevocable Life Insurance Trust is simply an arrangement created during the lifetime of the Grantor (the person establishing the Trust) under which one party (the Trustee) holds property for the benefit of someone else (the beneficiary). The Grantor completely relinquishes the Grantor's ownership interest in any property placed in the Trust and surrenders all right to alter, amend, revoke or terminate the Trust. The Trust would be the owner and beneficiary of all life insurance policies placed in trust by the Grantor. Any policies initially applied for by the Trustee, on behalf of the Trust, would be issued with the Trust as owner and beneficiary of any such policy(ies).

Typically, an Irrevocable Life Insurance Trust is funded by a Grantor who transfers one or more life insurance policies (insuring the life of the Grantor) into the Trust. The life insurance policies on the life of the Grantor may, but need not, represent the entire corpus of such Trust. The Trustee of the Trust is vested with all incidents of ownership in the policies. The goal is to exclude the proceeds (i.e., the face value of the life insurance policy) from the Grantor's estate for estate tax purposes upon the death of the Grantor.

By utilizing this estate planning techniques for the purchase of a new policy, policy proceeds are removed from the taxable estate of the insured/Grantor.

In the case of insurance policies on the life of the insured/Grantor already in existence prior to creating the Trust, assuming the Trust is properly established and the insured/Grantor does not die within

three (3) years after the Trust acquires ownership of the policy, the death benefit proceeds of the previously existing insurance policies should not be subject to estate tax.

Additionally, the plan creates liquidity for the estate of the insured/Grantor. For example, under such an arrangement, the Trustee can be authorized to make loans to, or purchase assets from, the Grantor's estate in order to provide liquidity for payment of estate settlement costs (including taxes).

II. ESTATE SETTLEMENT COSTS

Certain unavoidable expenses arise in the settlement of an estate. They consist of the cost of administering the estate (e.g., executor's commissions, appraisal fees, court costs and legal fees), federal and state estate taxes, outstanding debts (including the costs of the decedent's final illness) and funeral and burial expenses. These expenses may be minimized through careful planning, but it may not be possible to eliminate them completely.

III. USE OF LIFE INSURANCE

As previously mentioned, life insurance offers a most effective and economical method to create the cash necessary to pay estate settlement costs. An adequate amount of insurance eliminates the necessity of using other assets, both liquid and non-liquid, to meet estate expenses. Thus, insurance permits these other assets to be preserved for family members.

The following are sound reasons why life insurance is generally considered the ideal way to preserve estate assets and alleviate liquidity problems:

- * The proceeds become payable at exactly the time they are needed to pay estate settlement costs (i.e., at the time of death of the insured).

- * The full face amount is payable no matter when death occurs. This is so even if death is premature and/or occurs after payment of only one premium.

* The death benefit generally represents discounted dollars far exceeding the total premiums paid.

* The use of life insurance makes additional funds available for investment purposes to increase family security.

IV. ADVANTAGES OF AN IRREVOCABLE LIFE INSURANCE TRUST

Some of the advantages of a properly drafted Irrevocable Life Insurance Trust are:

* Upon the death of the insured, the Trustee can collect the proceeds payable under the policies without the costs and delays of probate.

* The death benefit proceeds would not be includable in the insured/Grantor's estate for estate tax purposes if the trust purchased the insurance or death occurs more than three (3) years after the policy is placed in the Trust. In addition, it may be possible to keep the Trust corpus out of the surviving spouse's estate for estate tax purposes.

* The Trustee may be authorized to make loans to or purchase assets from the insured's estate, thereby providing the liquidity necessary to pay taxes (estate and income) and other estate settlement costs.

* If life insurance is the only asset of the Trust (i.e., the Trust has no taxable income such as taxable distributions with respect to the life insurance policy or earnings from temporary investments), there should be no income taxation and therefore no filing requirements during the Grantor's lifetime.

* The Trustee would make premium payments from the cash gifts received from the Grantor.

* The Trustee would notify the "Crummey" beneficiaries of their withdrawal rights and maintain records of these notifications thereby qualifying gifts for the Trust for the annual gift tax exclusion.

V. ESTATE AND GIFT TAX ASPECTS

A. The Estate Taxation of Life Insurance:

Under Section 2042 of the Internal Revenue Code, the death benefit proceeds of a life insurance policy are includable in the decedent/insured's estate if: (1) they are payable to or for the benefit of the estate, or (2) the decedent possessed alone or in conjunction with another "incidents of ownership" in the policy at the time of death.

The term "incidents of ownership" is not limited in its meaning to the ownership of a policy in the technical legal sense but refers to the right of the insured or his/her estate to the economic benefits of the policy. Thus, the insured does not have to actually own the policy for the proceeds to be included in his/her gross estate at death. The power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan or to obtain a loan against the cash surrender value from the insurer are all examples of "incidents of ownership" found in the Treasury Department's regulations.

Thus, in order to keep the proceeds of a policy out of the insured's estate for estate tax purposes, the estate must not be the direct or indirect beneficiary and someone other than the insured should own the policy with no incidents of ownership in the insured. As indicated above, an Irrevocable Life Insurance Trust may be the ideal estate planning vehicle to accomplish this.

Section 2035 of the Internal Revenue Code provides that the gross estate of a decedent included the value of any property in which the decedent had an interest and had transferred within three (3) years of death if the transferred property would, but for the transfer, be includable in the decedent's estate under Section 2042. Thus, if an individual purchases a policy on his/her life and dies within three (3) years after transferring ownership to a third party, the death proceeds would be includable in the

decedent/insured's estate for estate tax purposes even though the estate is not the direct or indirect beneficiary and the insured does not possess any incidents of ownership at the time of death.

B. Gifts in Trust and the Crummey Withdrawal Rights:

As noted earlier, an Irrevocable Life Insurance Trust is an excellent estate planning tool to exclude the proceeds of an insurance policy on the insured's life from his/her estate for estate tax purposes. However, such an arrangement does have gift tax consequences. Ordinarily, the transfer of a policy to the Trust, the payment of premiums on the policy, and gifts of cash to the Trust to cover premium payments are considered gifts to the Trust beneficiaries. The general rule is that such gifts in Trust are gifts of a future interest which do not qualify for the annual gift tax exclusion of (currently \$13,000 per person and \$26,000 for split gifts by husband and wife) since the beneficiaries do not have the present use and enjoyment of such gifted amounts. One way to eliminate this problem is to give the Trust beneficiaries the right to withdraw a ratable portion of the contributions which are made to the Trust. This right is often referred to as a "Crummey" power and is generally exercisable by the beneficiary within a limited period of time (such as 30 or 60 days) and lapses if not acted upon. A Crummey power is designed to give each beneficiary a present interest in the contributions made to the Trust so that annual gift tax exclusions are available both for the original policy transfer and subsequent annual additions made to the Trust to cover premium payments.

In the event that the Trust beneficiaries allow their Crummey power to lapse, the Trust will remain in a position to pay premiums each year as they become due. However, a Crummey power is considered to be a general power of appointment and allowing it to lapse (i.e., the beneficiary fails to exercise their right of withdrawal) may result in a taxable gift of a future interest by the beneficiary to the remaining beneficiaries of the Trust. But the lapse of such a power is not treated as a gift by the holder of the

Crummey power to the extent that the property subject to the power does not exceed the greater of \$5,000 or five (5%) percent of the value of the entire Trust property.

Unfortunately, this exception, which is commonly known as the "5 and 5 rule" does not parallel the annual gift tax exclusion. For example: a \$24,000 ratable Crummey withdrawal power for a Trust beneficiary would qualify for an annual gift tax exclusion by the Grantor (where the spouse consents to the gift), but it results in a taxable lapse (gift) of \$19,000 (i.e., \$24,000 minus \$5,000) by the beneficiary who fails to exercise the right. Thus, funding an Irrevocable Life Insurance Trust with maximum gift tax annual exclusions through the use of Crummey withdrawal rights could result in adverse gift tax consequences when such rights are not exercised. Generally, \$5,000 will be greater than five (5%) percent of the corpus of the Trust since, typically, such Trusts are unfunded except for the life insurance policy(ies). However, depending on the size of the policy, the cash value may become a significant factor in the future and permit a Crummey withdrawal right of more than \$5,000 without adverse gift tax consequences.

Various alternatives have been developed which attempt to achieve the full \$13,000 (or \$26,000 for split gifts by husband and wife) annual exclusion for gifts in Trusts without creating a taxable gift by the Crummey beneficiary. These alternatives structure the Crummey provision in such a manner so that the non-exercise of the withdrawal right may not be complete for gift tax purposes. Usually, only a portion of the withdrawal right permitted by the "5 and 5 rule" will lapse, with the balance becoming subject to either a testamentary power of appointment or a so-called "hanging power". Thus, in the example given above of a \$24,000 withdrawal power, only \$5,000 would lapse upon non-exercise and the balance of \$19,000 would either be subject to a testamentary power of appointment by the beneficiary, or simply "hang" (i.e., not "lapse"). The Trust could provide that the cumulative "hanging" balance lapse in \$5,000 annual increments if contributions to the Trust cease at some point in the future. This may be especially

significant in situations where a "vanishing" premium concept is being utilized to purchase the life insurance. In the final analysis, it is not entirely clear how the IRS will view these types of alternatives.

IRS CIRCULAR 230 DISCLOSURE: To ensure compliance with Treasury Department regulations, we inform you that any U.S. federal tax advice contained in this correspondence (including attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

CHECKLIST AFTER EXECUTION OF A LIFE INSURANCE TRUST

1. An Internal Revenue Service SS-4 application has been filed in the appropriate office of the IRS in order to procure a Taxpayer Identification Number for the Trust. Once the IRS has processed the Taxpayer Identification Number application, confirmation will be sent directly to the Trustee and

not to this law office. The Trustee should receive the confirmation number in approximately 4-6 weeks.

2. A separate bank account should be opened by the Trustees in the name of the Irrevocable Life Insurance Trust, using the assigned Taxpayer Identification Number.

3. Acquisition of a new policy:

The Trustee should purchase a life insurance policy on the life of the insured, complete the application and arrange for the insured to have any necessary medical exams. The Trust should be designated as both the owner and the beneficiary of the policy.

Assignment of an Existing Policy:

If a policy on the life of the insured already exists, the owner of the property (e.g. the insured) must assign the existing policy to the Trust and designate the Trust as the beneficiary and the owner of the policy. The owner should review the policy to determine the restrictions, if any, on assignment of the policy. The Grantor should discuss with his accountant the gift tax consequences of transferring an existing policy to the Trust. A gift tax return may have to be filed if the transfer exceeds the \$13,000 annual exclusion.

4. The Grantor(s) of the Irrevocable Trust should write out checks to the Trustees of the Trust at least thirty (30) days before a premium payment is due and such check should be in an amount different than the premium due (e.g., if premium due is, \$5,000.00, then check amount should be no less than \$5,250.00).

5. Upon receipt of the funds by the Trustees, the Trustees should send out "Crummey Notice" letters to all of the beneficiaries of the Trust. A sample Crummey Notice letter is attached. The Crummey Notice Letter should be sent certified mail, return receipt requested. In the event a beneficiary is a minor, the letter may be sent to his or her legal guardian.

The Crummey Notice Letter should be sent out annually until premium payments cease.

6. The Trustees should not remit premium payments to the insurance company until the number of days as set forth in the Crummey Notice Letter for withdrawal of the additions to the Trust by the beneficiaries has passed. However, premium payments can be made as soon as all of the beneficiaries have released their withdrawal rights in writing to the Trustees.

7. Any excess cash in the Trust account after payment of the premiums should be put into some type of interest bearing account. The Trustees are required to file a Form 1041 - Fiduciary Tax Return, annually, assuming that interest income is generated by the Trust. If no interest income is generated by the Trust, then the Trustees are required to file only an informational tax return.

8. Upon the death of the insured, consider the need to file a gift tax return and allocate GST exemption (Form 709).

9. Upon the death of the insured, the Trustee should collect the insurance proceeds by providing proof of death to the insurance company.

SAMPLE

**Notice Letter
(the "Crummey Notice")**

TO: _____

Re: The _____ Irrevocable Trust

Dear _____:

This is to notify you that a contribution in the amount of \$_____ was made to **The** _____ **Irrevocable Trust** (the "Trust"). Under the terms of the Trust you have the right to withdraw all or a portion of this contribution, or other property equal in value from the Trust. Your right of withdrawal shall lapse based on a time period set forth under the terms of the Trust. If you intend to exercise your right of withdrawal, please deliver a notice, in writing, to the Trustee of the Trust. For your information, a copy of the Trust Agreement which sets forth your right of withdrawal, is retained by the Trustee if you would like to review it.

Please acknowledge receipt of this letter by signing and dating the enclosed copy and returning it to me in the enclosed self-addressed envelope.

Very truly yours,

_____, Trustee

Received by:

Date: _____