John Hancock

LIFE INSURANCE

Success Strategy

Spousal Access Trusts

PLANNING STRATEGIES FOR SUCCESSFUL CLIENTS

Married couples often create Irrevocable Life Insurance Trusts (ILITs) to replace income in the event of an untimely death, and to pay estate taxes and other expenses of estate administration.[1] ILITs have traditionally been an important vehicle for leveraging lifetime gifts with life insurance, and the trust will usually receive the life insurance death benefit free of income and estate taxes. However, a common complaint about ILITs is that both husband and wife lose the ability to access the life insurance policy's cash value during the insured's life. A Spousal Access Trust is a variation on a traditional ILIT that can provide flexibility and access for married clients who are buying a life insurance policy.

WHAT IS A SPOUSAL ACCESS TRUST?

A Spousal Access Trust is a type of ILIT that enables the spouse of the trust grantor (the individual who establishes the trust) to receive distributions from the trust during his/her lifetime. A Spousal Access Trust names the spouse of the grantor, in addition to the children of the grantor, as trust beneficiaries. A Spousal Access Trust can be used with either a single life or a survivorship life insurance policy, and as long as the trust is drafted and administered correctly, it will also have the tax benefits of a traditional ILIT.

HOW DOES IT WORK?

You are allowed to make annual exclusion gifts up to $13,000 per person each year without having to pay gift taxes. You can use the annual exclusion gifts to fund an ILIT for the benefit of your spouse and children. The trust will own a life insurance policy and receive the death benefit free of estate and income taxes. The policy cash value will grow inside the trust on a tax-favored basis. The trust document will provide that distributions can be made from the trust to your spouse and children during your lifetime, usually for health, education, maintenance and support.[2]

In addition to the annual exclusion, in 2011 and 2012 only, an individual can give away up to $5,000,000 during lifetime (known as the lifetime exemption amount) without gift taxes. Beginning in 2013 this exemption amount drops to $1,000,000. Therefore, there is a two-year window to utilize the higher exemption to make lifetime gifts and leverage them with life insurance.[3]

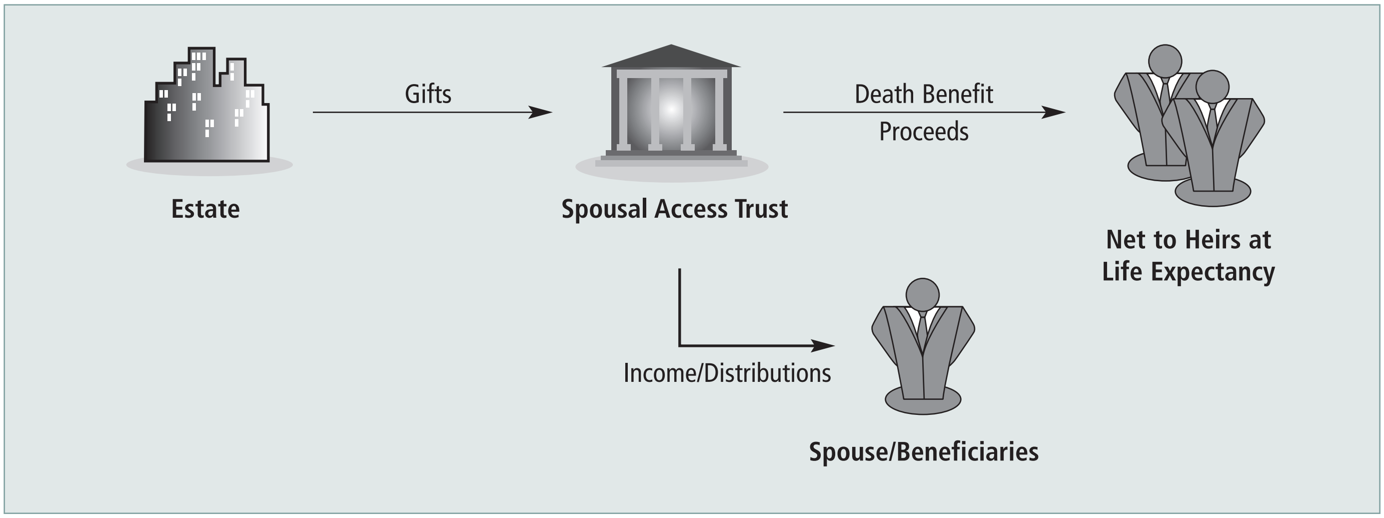
BENEFITS

- The trust will receive the death benefit free from income and estate taxes.
- An irrevocable trust can protect assets from creditors and protect your family's privacy.[4]
- When gifts are used to purchase life insurance, lifetime giving can increase the amount of money left for your heirs.
- A Spousal Access Trust allows distributions to the grantor's spouse and children during his/her lifetime, allowing access to the policy cash value.
- The trustee can make distributions to provide supplemental retirement income for the grantor's spouse via policy loans and withdrawals.

CONSIDERATIONS

- Transfers of assets to an ILIT are irrevocable, and may only be used for the benefit of the trust beneficiaries.
- Taking policy loans and withdrawals from a life insurance policy during the insured's lifetime can reduce the available death benefit, cash surrender value and may cause the policy to lapse.[5]
- Withdrawals and loans from life insurance policies classified as modified endowment contracts may be subject to income tax, and may also be subject to a federal tax penalty if the withdrawal or loan is taken prior to age $59\frac{1}{2}$.

The chart below shows how the Spousal Access Trust works.



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1. Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
2. See IRC Section 2041. To avoid giving the beneficiary spouse any incidents of ownership with a Survivorship Spousal Access Trust, the authority to make distributions to the surviving spouse may need to be limited to an independent trustee with absolute discretion. See PLR 200617008. Consult your tax advisors.
3. Under the current law, which is based on the "Unemployment Insurance Reauthorization and Job Creation Act of 2010," the maximum estate tax rate is 35% with a $5,000,000 exemption for each individual. The $5,000,000 exemption amount can be used either during lifetime, as a gift tax exemption amount, or at death as an estate tax exemption. In addition, each individual has a $5,000,000 exemption to the generation-skipping transfer (GST) tax; this $5,000,000 can be used during life or at death. Effective January 1, 2013, the exemption amount for each of the gift, estate and GST taxes drops to $1M and the top tax rate for each is 55%.
4. Assuming the proposed initial gift was not a fraudulent conveyance meant to inhibit creditors.
5. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Cash value available for loans and withdrawals may be more or less than originally invested. Withdrawals are available in the second policy year.

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