Principal®

Irrevocable life insurance trust and gifting strategies

Enjoy confidence and control in your estate plan.

Have you thought about the legacy you would like to leave?

By planning now, you can help ensure your estate goals are met when the time comes. You can also address important issues, such as:

Who
you want to benefit from your estate

What
your goals are for distributing your assets

How
to minimize the impact of taxes

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An irrevocable life insurance trust may help protect your estate.

People with estates of all sizes share this common concern: making sure their family receives the full benefit of their lifetime's work. However, those with larger estates, potentially subject to the federal estate tax, have the added concern of the effect of the tax on their legacy. An irrevocable life insurance trust (ILIT) can address this issue. It can help you do the following:

- Meet the liquidity needs of your estate.
- Avoid estate taxation of the death proceeds.
- Generate income for your family members.
- Provide creditor protection of your property.

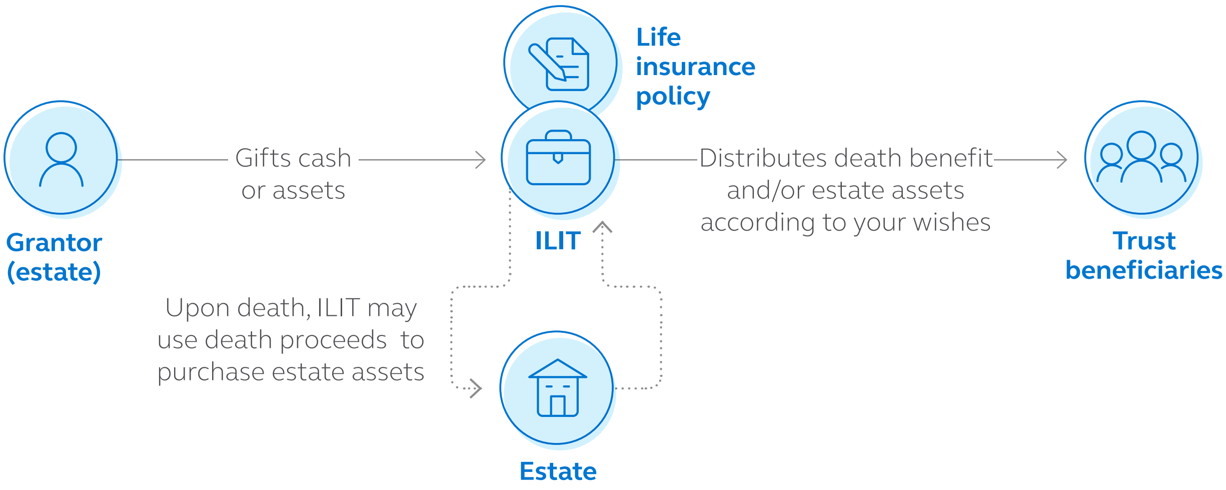
This guide will show you:

- How an ILIT works
- How an ILIT helps protect your estate
- What things you'll want to consider
- What you should look for in a trustee
- How to get started

Setting up a trust now allows you to make strategic decisions and gain confidence in what will happen to your estate later.

Here's how an ILIT works

- As the grantor, you establish the ILIT and gift cash or assets to the trust.
- Generally, the trust then purchases, pays for, and is the owner and beneficiary of an insurance policy on you, or you and your spouse.
- Upon death, the trust receives the life insurance death proceeds.
- Typically, the trustee uses the proceeds to purchase assets from your estate. This helps assure your estate will have cash to pay the taxes.
- The trust distributes any assets to the beneficiaries according to your wishes.



What does it all mean?

Let's start with some basics.

Grantor. The person/people who create the trust.

Irrevocable. When a trust is irrevocable, it means it's final and generally can't be changed. You give up rights to the property transferred to the trust.

Trust beneficiaries. The people you want to receive the benefits paid from the trust. In most instances, your beneficiaries are family members—children, grandchildren, and perhaps their spouses.

Trustee. The person or firm you select to administer and carry out the terms of the trust.

How an ILIT helps protect your estate

An ILIT can provide liquidity to pay final expenses without subjecting the money to estate or inheritance tax. Using spendthrift and other clauses, it can protect your estate from claims by future creditors, or divorcing spouses of trust beneficiaries. However, the most important benefit of an ILIT is that it can help address potential tax concerns.

Here are the transfer taxes that could affect what's available to your loved ones and how an ILIT can make a difference.

Estate tax:

An ILIT can help you exclude life insurance proceeds.

Generally, when you're the owner and the insured of a life insurance policy, the death benefit proceeds paid are included in your estate for federal estate tax purposes. But, a properly drafted ILIT can exclude these proceeds from the federal estate tax calculation for you and your spouse.

There are a few guidelines, however, that need to be followed to keep the life insurance proceeds estate tax-free. You and your spouse:

- Cannot be the owner or indirect owner of the life insurance policy;
- Cannot have any direct control over operation of the trust; and
- Cannot receive any benefit from trust assets.

Gift tax:

An ILIT can help you make the most of annual exclusion gifts.

Cash gifts you make to the ILIT are generally one of two types.

What else you should know:

- If you're already insured on a life insurance policy, it can be transferred to your ILIT as a gift. To avoid proceeds being taxed in your estate, you must live at least three years after the transfer (three-year rule). This same method can be used for both an individual and survivorship life policy.
- An alternative to gifting the policy is to sell it to the ILIT for its fair market value. This helps avoid the three-year rule, as long as certain requirements are met. And if the ILIT is a grantor trust with respect to the insured for income tax purposes, sale of the policy to the ILIT won't violate the transfer for value rule.

1 Annual exclusion gifts

These allow you to make an annual gift to the ILIT of up to $16,000 (indexed) without paying gift tax. (The annual exclusion gift is limited to $16,000 per person, which would include all gifts you give to that person.) Annual exclusion gifts aren't aren't subject to gift tax, and generally don't require filing a gift tax return. You typically can make the same number of annual exclusion gifts as the number of ILIT beneficiaries.

In order for a gift to qualify for the gift tax annual exclusion, the gift must provide trust beneficiaries with a present interest in the transferred property. This generally is accomplished by notifying trust beneficiaries of their right to withdraw their share of the contribution (known as a "Crummey" withdrawal power).

Any gifts in excess of the annual exclusion amount will be applied to the lifetime gift tax exemption. Annual exclusion gifts, appreciation in value of the gifts, and any taxable gifts are generally removed from the donor's taxable estate.

2 Taxable gifts

Any gifts in excess of the annual exclusion amount are considered taxable gifts and will be applied to the lifetime gift tax exemption, currently $12,060,000 (indexed)[1]. Generally, you and your spouse each may make gifts up to this amount without paying any gift tax. Any gifts above that require the payment of gift tax.

Annual exclusion gifts you make to the ILIT to pay for life insurance typically amount to much less than the value of the death benefit they purchase. So, you may be able to turn these smaller gifts into greater trust assets at death. Plus, taking advantage of the annual exclusion gifts available to you reduces your taxable estate.

Income tax:

An ILIT can help you be strategic with income tax.

With life insurance being the most commonly used asset inside the ILIT, any cash value accumulation growth is tax-deferred and no annual income tax will be payable. Also, if you use assets that might otherwise be income-producing to pay for life insurance, using the ILIT may reduce your taxable income.

What else you should know:

- If your ILIT is a grantor trust for income tax purposes, any trust income is reportable on your personal income tax return.
- If your ILIT is not a grantor trust for income tax purposes, it will need a tax ID number and must file its own tax return.
- When done properly, a life insurance policy owned by an ILIT can generally be exchanged for a new policy without incurring a current tax liability.

Generation-skipping transfer tax:

An ILIT can help you plan transfers through multiple generations.

A generation-skipping transfer (GST) tax is imposed on transfers of assets to those who are two or more generations removed from you. This would include your grandchildren, great-grandchildren, and other similar relatives. Both you and your spouse each have a GST tax exemption of $12,060,000 (indexed)[1], which can be used for transfers during your life and at death.

A common strategy used to minimize any GST tax is to allocate life insurance policy payments against the GST exemption.

[1] The exemption amount is scheduled to sunset after 2025 and revert to its 2017 numbers, adjusted for inflation.

Factors to consider with an ILIT

As you consider implementing an ILIT, here are some things to keep in mind.

It's irrevocable. It's difficult to amend the trust if the situation or your wishes change. Also, you can't access any cash value from the life insurance policy or use it as collateral. You should make sure the benefits outweigh this inflexibility.

It can be complex. Strategies that deal with tax law are often complex, and an ILIT is no exception. It's possible that an advantage provided by one area of tax law could result in an unintended disadvantage in another area. Therefore, it's important to to consult your tax and legal advisors.

It may require alternative financing. If available gift tax annual exclusions aren't enough to pay for the ILIT-owned life insurance, you may need different strategies to pay for the coverage.

It may require extra administration. In addition to directing premium payments through a trust bank account, when "Crummey" powers are included, you'll also need administrative services to manage annual "Crummey" notices.

It comes with a cost. Applicable attorney and trustee fees should be considered.

An ILIT serves many purposes in wealth transfer planning and may offer flexibility that can be customized to your unique situation.

Leave more with gifting.

Using an ILIT as part of a gifting strategy can increase the amount you leave for your loved ones and provide more liquidity for the estate. Let's see how it can work in an example.

Pat and Chris have a $50 million estate. They're considering making a $10 million gift of an appreciating asset (real estate or a business, for example). Here are three possible decisions they might make:

Do nothing. The **assets and all future appreciation are included** in their taxable estate.

Gift an appreciating asset to heirs today. The **gift and all future appreciation are removed** from their taxable estate.

Gift cash or an asset to an ILIT and purchase life insurance. The **gift and all future appreciation are removed** from their taxable estate, and the life insurance **provides liquidity** for tax bills, legacy planning and survivor income.

Let's review the impact of gifting:

Gifting illustration

	$10 million gift to heirs		$10 million gift to an ILIT and purchase life insurance		
Year	Total trust assets after 5% growth[2]	Benefit to heirs	Total trust assets after premium & 5% growth[2]	Life insurance death benefit[3]	Benefit to heirs (assets + insurance)
5	$12,762,816	$12,762,816	$12,435,240	$5,000,000	$17,435,240
10	$16,288,946	$16,288,946	$15,543,291	$5,000,000	$20,543,291
15	$20,789,282	$20,789,282	$19,510,040	$5,000,000	$24,510,040
20	$26,532,977	$26,532,977	$24,572,728	$5,000,000	$29,572,728
25	$33,863,549	$33,863,549	$31,034,144	$5,000,000	$36,034,144

[2] Pre-discounted value of assets transferred to the trust is $10 million. Growth rates in this presentation aren't guaranteed, and actual results may be more or less favorable.

[3] $5 million death benefit is based on a male, age 60 Preferred Non-Tobacco, and a female, age 60. An annual premium of $56,460 is paid for 39 years and guarantees coverage to female's age 100.

What you need to know about lifetime gifting

Here are some things to keep in mind.

Gifts generally can't be recovered by the grantor. You must give up complete control of the asset and any income it provides.

There's no adjustment in basis for lifetime gifts. This means beneficiaries who receive an appreciated asset will have the same cost basis in the asset as the donor (you) did. This may result in a greater amount of capital gain tax for the beneficiary when the asset is sold.

Gift and estate taxes are unified. Annual exclusions and lifetime exemptions are maximized because the gift removes the value of the asset, its growth, and any income produced by the asset from your taxable estate. Then, any unused lifetime exemption can be used by your estate to reduce estate taxes that may be due.

> Lifetime gifting strategies offer a tax-efficient way to transfer wealth. And when you use gifts for ILIT-owned life insurance, you can provide greater liquidity and enhanced gift value to your estate.

The role of the trustee

Each trust has a trustee. This is a person or institution you choose to carry out the objectives and follow the terms of your trust. Because of the importance of the role, you want it to be someone you have confidence in. And it's generally not advisable for it to be you or your spouse. Some of the characteristics you should look for in a trustee are:

- Competence
- Availability
- Ability to act as a fiduciary for the beneficiaries of the trust
- Experience as a trustee or good business knowledge
- Impartiality, with no conflict of interest
- Willingness to do it

A trustee is generally a family member, friend, business associate, private investment advisor, attorney, accountant, corporate trustee, or a combination of these. You should also name a successor trustee in case your trustee becomes unable to perform the duties.

8 steps to help protect your estate

Once you decide an ILIT is right for you and your family, here are the steps to gain confidence and control in your estate plan. Your financial professional will help you along the way.

1 | The attorney **drafts an ILIT** that gives the trustee the authority to purchase life insurance on you, or you and your spouse.

2 | You open a **non-interest-bearing trust account** and secure a tax ID number.

3 | You and your financial professional select the **Principal life insurance policy** that works best for your situation. The trustee applies for the policy with the trust as the initial owner and beneficiary. You, and your spouse if it's a survivorship policy, will be the insured(s).

4 | **Underwriting** takes place as part of the application process, and may require you to take a medical exam.

5 | You make **cash gifts** to the trust.

6 | The trustee sends **"Crummey" notices** to the beneficiaries to inform them of the gifts and that they have a certain time (generally 30 days) during which they can withdraw their share of the gift.

7 | After the **right of withdrawal period** has expired, the trustee pays the premium.

8 | The trustee gains access to **policy details** at **principal.com** to effectively manage the policy and meet the objectives of the trust.

An industry leader in your corner

Your legacy is important. Creating your estate plan today can give you the confidence and control to know that it will be passed on to your loved ones the way you intend. Equally important is the company you choose to partner with to help ensure the plan design meets your goals.

Everything you need in one place

Once you decide this plan is right for you, we'll bring our expertise and resources to the table to help you put the plan in place. Everything you need to successfully implement and maintain a plan is available at Principal:

Experienced professionals

Dependable products

Comprehensive service

Expertise and leadership every step of the way

Our priority is to understand where you want to be and then help you get there. Our dedicated team of experienced attorneys and Certified Public Accountants (CPAs)[4] works with your financial professional and tax and/or legal advisors. Together, we deliver innovative ideas and real-life solutions that make your financial progress possible.

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- We have been offering life insurance for over 140 years.
- Principal Trust Company℠ offers comprehensive trust administration services with a wide variety of trust types, tools, and support.

[4] Attorneys and CPAs do not provide legal, tax or accounting services on behalf of the companies of the Principal Financial Group®.

[5] As of December 31, 2021.

[6] Third-party ratings relate only to Principal Life Insurance Company, the largest member company of the Principal Financial Group®, and Principal National Life Insurance Company, and do not reflect any ratings actions or notices relating to the U.S. life insurance measure to help select among insurance companies, they are not guarantees of the future financial strength and/or claims-paying ability of a company and do not apply to any underlying variable investment options. The broker/dealer a life insurance policy is purchased from, the insurance agency and any affiliates of those entities make no representations regarding the quality of the analysis conducted by the rating agencies. The rating agencies are not affiliated with the above mentioned entities.

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