Choreo

CASE STUDY

ESTATE PLANNING

Trustee Liability Exposure:

Trust-Owned Life Insurance Requires Continual Oversight

NEEDS

An elderly couple faced an unexpected $75,000 bill for interest due on a premium financing loan for their $1 million life insurance policy. Additional funding for the policy was necessary because it had been placed in an irrevocable trust 30 years prior, and eventually depleted its cash value such that it could no longer cover the premiums due. Although the trust had been recommended by their existing advisor, their son, acting as trustee, questioned its suitability and asked Choreo to evaluate his parents' estate plan.

CHALLENGES

1. The couple had diligently maintained premium payments on their trust-owned life insurance for 30 years, never expecting a sudden balloon payment in order to keep the policy active.
2. The policy itself told a story of gradual decline, as the low-interest rate environment from 2010 to 2020 had significantly impacted the policy's performance while more recent rate increases had caused premium financing costs to spike dramatically.
3. While initially created to provide estate tax benefits, the irrevocable trust structure now posed challenges due to its inherent inflexibility. Additionally, its complexity was confusing, creating questions about the couple's future and their ability to leave a legacy to heirs.

SOLUTIONS

In its review, the Choreo team evaluated the trust's grantor status and options for potential restructuring considering any responsibilities and personal exposure the trustee might have.

1. First, the Choreo team addressed the confusion surrounding the policy and its implications. Specifically, the couple wanted to know:
   - Would surrendering the policy trigger a tax liability for the trust?
   - What would happen if the couple allowed the policy to lapse or if the trust were unable to pay any tax obligations?
   - What personal liability might their son, the trustee, face, and were there any options to minimize the family's financial exposure?
2. Through the team's analysis and cross-disciplinary collaboration, Choreo advisors charted a path forward. They determined any tax implications from policy changes would flow to the grantors rather than to the trust itself, immediately alleviating one of the family's primary concerns. This also opened the door to more flexible planning options.
3. The team then identified several options to restructure the policy while preserving key benefits. Options included:

SOLUTIONS (continued)

- The couple could continue paying the $75,000 in annual interest on the premium financing loan, maintaining the amount of death benefit as long as the couple accepted the ongoing burden on their cash flow.
- Alternatively, the couple could surrender the policy immediately and address any tax consequences, eliminating future payment obligations and related cashflow challenges.
- The couple could explore 1035 exchange options, allowing for restructuring the death benefit and opportunity for a premium optimization strategy.

4. The Choreo team then developed a framework that allowed family members to evaluate the presented options based on both immediate financial impact and long-term estate planning goals. The resulting analysis determined the son's personal liability exposure as trustee was minimal, addressing the family's concerns about personal risk.

THE BOTTOM LINE

Estate planning is never a one-time exercise. It requires ongoing attention from engaged experts, particularly when the plan involves trust-owned life insurance.

Choreo advisors educated the family about cash-value life insurance policy management with performance reviews, professional oversight from financial, legal and tax advisors, and trust administration with written procedures for policy evaluation and decision-making. Moving forward, the family will be better able to address potential estate issues proactively, rather than experiencing surprises impacting their cashflow, wealth and legacy.

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