"B" Trust Funding

"Provide estate liquidity without using your annual exclusion gifts."

We offer you this concept piece to help you understand how life insurance can be used to provide funds to help implement your estate planning arrangements. This material is designed to provide general information in regard to the subject matter covered. It should be used with the understanding that it does not constitute legal, accounting or tax advice. Such services should be provided by the client's own legal, accounting and tax advisors. Accordingly, information in this document cannot be used for purposes of avoiding penalties under the Internal Revenue Code.

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Prudential

Do you identify with the following?

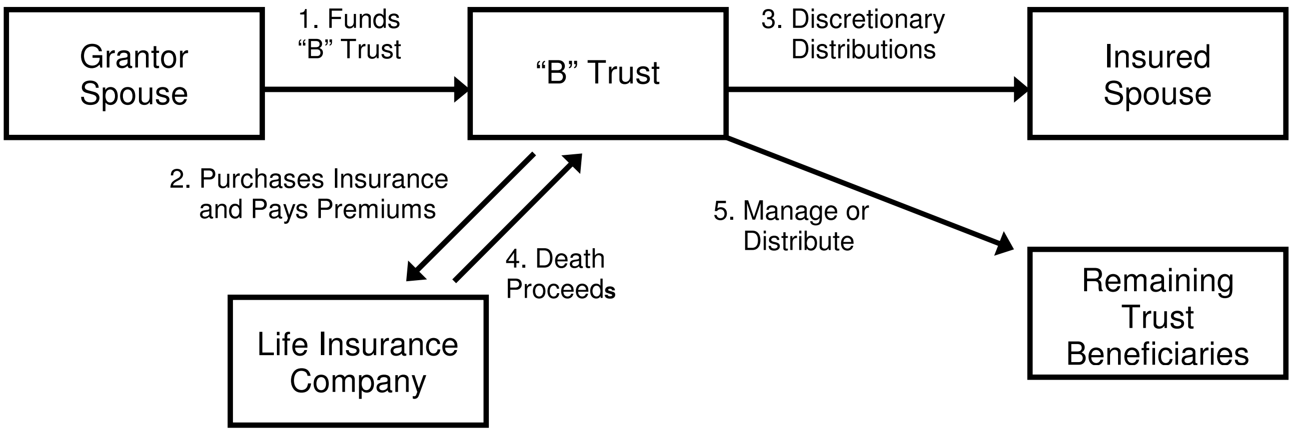
- You would like your family to have cash at your death to help pay estate taxes; and
- You are interested in purchasing a life insurance policy, owned outside of your estate, to help provide funds to pay taxes and expenses, but you are already making gifts to your heirs; and
- Your deceased spouse established a credit shelter trust (also may be known as a family trust or “B” trust), and it contains provisions permitting the purchase of life insurance; and
- You are a beneficiary of the trust with a lifetime limited interest, but you do not rely on the income from the trust to maintain your lifestyle because you receive sufficient income from other assets.

If so, you may want to consider using the funds in the “B” trust to purchase life insurance.

By using the “B” trust assets to purchase life insurance:

- Notwithstanding the time value of money, you may be able to use the trust assets to help provide a larger sum of money for estate liquidity on a transfer tax-free basis; and
- As beneficiary of the “B” trust, you retain the rights to income from the trust if needed.

Structure of "B" Trust Funding to Purchase Life Insurance



1. A credit shelter trust is established and funded (also known as a "B" trust). Normally this trust is established under a will and is funded at the death of the first-to-die spouse (grantor spouse). The other spouse (insured spouse) should NOT be a trustee but may be a beneficiary of the trust.

2. The trustee applies for a life insurance policy on the life of the trust beneficiary spouse. The trustee is applicant, owner, beneficiary and premium payer of the policy.

3. During the insured spouse's life, the trustee may make distributions of income and principal to the insured spouse (usually for health, education, maintenance, and support). [1]

4. Upon the insured spouse's death, life insurance proceeds are paid to the "B" Trust.

5. The trustee manages and/or distributes proceeds to any remaining trust beneficiaries according to the provisions of the trust.

[1] *Life insurance policy cash values are accessed through withdrawals and/or policy loans. Loans and withdrawals reduce the policy cash values and death benefit and may affect any guarantees against lapse. Loans are at interest. Unpaid loans and/or withdrawals cause a reduction in policy cash values and death benefits. In general, loans are not taxable, but withdrawals are taxable to the extent they exceed basis in the contract. Loans outstanding at policy lapse or surrender prior to the death of the insured will cause immediate taxation to the extent of gain in the contract. For policies that are Modified Endowment Contracts, distributions (including loans) will be subject to income tax to the extent of policy earnings and there may be an additional 10% federal income tax penalty for distributions prior to age 59½. Consult your tax advisor for advice regarding your particular situation.*

Advantages to the Trust Beneficiaries:

- The insured is potentially able to increase the amount of money ultimately passing to the remaining trust beneficiaries on a transfer tax-free basis.
- The insured is able to acquire life insurance outside of his/her taxable estate without using annual exclusion gifts.
- The trustee continues to have the option to invade the trust assets, including the policy cash values, for the benefit of the trust beneficiaries as provided by the terms of the trust document.
- Trust income taxes may be reduced through the tax-deferred growth of the cash value within the life insurance policy.
- Asset management is provided for trust beneficiaries.
- Remaining trust beneficiaries, who are usually the children, have the comfort of knowing that the trust assets are available within the terms of the trust to assist their surviving parent.
- At the death of the insured spouse, the trust receives the death proceeds that are generally income tax-free under IRC § 101(a). These funds can be distributed to the remaining trust beneficiaries or otherwise used according to the provisions of the trust document.

Tax Considerations:

- The initial transfer of assets to the "B" trust does not trigger gift or estate tax.
- Because insurance in the "B" trust is purchased with assets already in the trust, use of gift tax annual exclusion or other gifting strategies is not required.
- The death proceeds payable to the trust will not be included in the insured's taxable estate provided the insured spouse possesses no incidents of ownership in the life insurance policy and has not contributed to the purchase of the policy.
- The insured spouse should not be the sole trustee of the trust but may be a co-trustee. In that case, the terms of the trust must prohibit him/her from exercising any power over the insurance policy on his/her life.
- The premiums for the life insurance policy should be paid only with funds from the "B" trust. The insured spouse should not contribute to the maintenance of the policy.
- The insured spouse may have a limited beneficial interest in the trust such as an income interest and access to principal for purposes of health, education, maintenance and support. The insured spouse should not be given a limited power of appointment.
- The death benefits received are generally income tax-free under IRC Section 101(a). The interest potion of death benefits not received in a lump sum may incur some income tax liability.
- Your legal or tax advisors may want to refer to Private Letter Rulings 9748020 and 9840020.