Who Should Be the Owner and Beneficiary of My Life Insurance Policy?

Understanding the threat of estate taxes on your life insurance proceeds is your first step in protecting these funds from unnecessary taxation. The next steps are determining the appropriate ownership of your policy and selecting an appropriate beneficiary. While there are other alternatives, the life insurance trust can help avoid potential threats to the policy’s proceeds.

What Threats Exist Besides Estate Taxes?

There are many factors that may undermine the financial security provided by the proceeds of your life insurance policy. Beyond estate taxes, there is the potential for probate, gift taxes, financial mismanagement, and misuse. Proper planning is necessary to help avoid these threats.

Ownership Options*

Aside from yourself, there are three practical options for the ownership of your life insurance:

Your Spouse

If you choose your spouse to be the owner and beneficiary of a policy on your life, the proceeds of the policy will be subject to estate taxes and perhaps probate administration when he or she eventually dies. In addition, he or she will be responsible for investing the proceeds of your policy. Make sure your spouse is prepared and has the willingness to handle these additional responsibilities.

A Child

Naming a child as owner and beneficiary can lead to problems if the child lacks the experience for such a designation. You must be able to rely on him or her to maintain the policy and avoid letting the policy lapse. In addition, since your child will be the legal owner of the policy proceeds, you must be sure that he or she will be willing to supply necessary funds to the estate to settle taxes, fees, and other expenses.

An Irrevocable Life Insurance Trust

An irrevocable life insurance trust can help avoid these threats to your policy’s proceeds. Because the trustee must manage the trust for your benefit, it helps ensure the availability of liquid funds when they are most needed. And because the trust is irrevocable and is the owner and beneficiary of your policy, the proceeds escape estate taxes in most cases. The trust arrangement allows the proceeds to avoid probate administration. And the trust can allow for the professional management of the proceeds to help ensure the livelihood of your survivors. The use of a life insurance trust can provide an opportunity for families to utilize the benefits of their life insurance.

Keep in mind that the cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance. Before implementing this strategy, it would be prudent to have the policy approved. In addition, you should seek professional advice from an attorney before establishing such a trust.

* A taxable gift from the owner to the beneficiary may result when the owner, the beneficiary, and the insured are all different parties. To minimize the threat of gift taxes, the owner of the policy should be the beneficiary of the policy.