Estate Planning Insurance Considerations

"In a few hours of estate planning, many of our clients could save more than they have accumulated over the last several years."

Price Waterhouse

"Increasingly, business owners are buying life insurance to pay for estate taxes."

Wall Street Journal

The Problem:

There is a mistaken impression that, at death, your assets will automatically be distributed to your loved ones.

Instead, several "unwanted heirs" may step forward **FIRST** for their share of your estate.

These "unwanted heirs" include:

- Federal Estate Tax
- State Inheritance Tax
- Estate Administrative Costs
  (funeral expenses, probate costs, professional fees, final expenses and debts)

What Can This Mean to You?

The problem is that these "unwanted heirs" can siphon off a **significant portion** of an estate's total value.

High Cost of Dying

Gross Estate	Administrative Costs at 5% (1)	Taxable Estate	2009 Federal Estate Tax (2)
$ 1,000,000	$ 50,000	$ 950,000	$ 0
2,000,000	100,000	1,900,000	0
3,000,000	150,000	2,850,000	0
4,000,000	200,000	3,800,000	135,000
5,000,000	250,000	4,750,000	562,500
7,500,000	375,000	7,125,000	1,631,250
10,000,000	500,000	9,500,000	2,700,000
15,000,000	750,000	14,250,000	4,837,500
20,000,000	1,000,000	19,000,000	6,975,000

(1) Actual costs may be higher or lower.

(2) Based on the 2009 estate tax rates and $1,455,800 unified credit. The Economic Growth and Tax Relief Reconciliation Act of 2001 repeals the estate tax for one year – 2010. Under that law, the federal estate tax continued from 2001 through 2009, but with increasing unified credits and decreasing top estate tax rates, until 2010 when the federal estate tax is repealed, but only for 2010. Without future Congressional action, the 2001 federal estate tax rules will be reinstated in 2011, but with a $1 million exemption equivalent (as scheduled to increase prior to the Act).

What Can Be Learned from Public Probate Records?

You may be interested in what the public probate records of the estates of businessmen, attorneys, entertainers, accountants and even a President have to show.

Name	Gross Estate	Net Estate	Percent Shrinkage
Franklin D. Roosevelt	$ 1,940,999	$ 1,366,132	30%
Henry J. Kaiser, Sr.	$ 5,597,772	$ 3,109,408	44%
Edwin C. Ernst, CPA	$ 12,642,431	$ 5,518,319	56%
Robert S. Kerr (U.S. Senator, Oklahoma)	$ 20,800,000	$11,300,000	46%
A.H. Wiggin (Chairman, Chase Bank)	$ 20,493,999	$ 5,646,666	72%
William E. Boeing	$ 22,386,158	$11,796,410	47%
Rick Nelson	$ 744,357	$ 506,636	32%
Elvis Presley	$ 10,165,434	$ 2,790,799	73%
Rock Hudson	$ 8,600,000	$ 3,926,288	54%
James S. Kemper (Insurance Executive)	$ 10,948,356	$ 7,007,560	36%
Nelson A. Rockefeller	$ 79,249,475	$56,727,628	28%
Conrad Hilton	$199,070,700	$93,288,483	53%
Source: Public Probate Records			

If these people, who had access to the best advice money could buy, were not able to avoid the "unwanted heirs" (federal and state estate taxes an estate administrative costs), it will be difficult for the rest of us to avoid estate settlement costs.

There are, however, steps to be taken...

The Federal Estate Tax:

The federal estate tax is a progressive tax on the right to transfer property at death. In 2009, federal estate tax rates began at 18% and increased to as much as 45% of the taxable value of an estate. Due to the estate tax unified credit, estates valued at $3,500,000 or less in 2009 were exempt from the federal estate tax.

The Federal Estate Tax

The Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 Tax Relief Act), signed into law by President Bush on June 7, 2001, made significant changes to the estate tax, but only for the period from 2001 through 2010:

Estate tax rates were reduced and exemption equivalents of the estate tax unified credit were increased for 2001 through 2009.

The Act then repeals the estate tax for 2010.

BUT…

The entire 2001 Tax Relief Act will automatically terminate, or "sunset," at the end of 2010 unless a future Congress takes action to extend its provisions.

The Federal Estate Tax

This means that, under current law, **the estate tax resumes in 2011, generally as it existed prior to the Act!**

In general, the repeal of the estate tax for only one year in 2010 requires planning as if there will be no repeal.

Since the estate tax is **progressive, and administrative costs grow with the estate, it is important first to consider the impact of the growth of your estate on the amount payable to your "unwanted heirs."**

What Are the Estate Growth Implications for a Married Couple?

In a properly arranged estate, the size of a married couple's estate at the death of the surviving spouse determines the estate taxes due. Consider the following:

Current Ages of Spouses		Additional Years to Estimated Joint Life Expectancy*	Estate Growth Rate Factors		
Male	Female		5%	8%	10%
40	40	49	10.921	43.427	106.719
50	45	42	7.762	25.339	54.764
50	50	39	6.705	20.115	41.145
55	50	37	6.081	17.246	34.004
60	55	32	4.765	11.737	21.114
60	60	30	4.322	10.063	17.449
65	60	28	3.920	8.627	14.421
70	65	23	3.072	5.871	8.954
70	70	21	2.786	5.034	7.400
75	70	19	2.527	4.316	6.116

* Based on IRS Annuity Table VI.

FOR EXAMPLE…

A husband age 55 and wife age 50 with an estimated $1,000,000 taxable estate today can expect to see it grow to $17,246,000 at 8% by the time the surviving spouse dies in 37 years. This results in the following estate settlement costs and estate shrinkage, assuming that no part of the estate growth is consumed:

$	17,246,000	Taxable Estate
-	8,625,220	Federal Estate Tax [1]
-	862,300	Administrative Cost (5%)
$	7,758,480	Net Estate to Heirs

$ 9,487,520 Total Estate Shrinkage (55%)

(1) Based on the estate reduced by administration costs, on 2001 estate tax rates and a $1 million unified credit equivalent. The Economic Growth and Tax Relief Reconciliation Act of 2001 repealed the estate tax for one year – 2010. Under that law, the federal estate tax continued, but with increasing unified credits and decreasing top estate tax rates, until 2010 when it is repealed only for that year. Without future Congressional action, the 2001 federal estate tax rules will be reinstated in 2011, but with a $1 million exemption equivalent (as scheduled to increase prior to the Act).

What Are the Estate Growth Implications for a Single Person?

In the case of a single person, the size of the individual's estate at death determines the estate taxes due. Consider the following:

Current Age	Additional Years to Estimated Life Expectancy*	Estate Growth Rate Factors 5%	8%	10%
40	43	8.150	27.367	60.240
45	38	6.385	18.625	37.404
50	33	5.003	12.676	23.225
55	29	4.116	9.317	15.863
60	24	3.225	6.341	9.850
65	20	2.653	4.661	6.727
70	16	2.183	3.426	4.595
75	13	1.886	2.720	3.452
80	10	1.629	2.159	2.594

* Based on IRS Annuity Table VI.

FOR EXAMPLE...

A single person age 65 with an estimated $1,000,000 taxable estate today can expect to see it grow to $4,661,000 at 8% by the time death occurs in 20 years. This results in the following estate settlement costs and estate shrinkage, assuming that no part of the estate growth is consumed:

$ 4,661,000	Taxable Estate
- 1,730,373	Federal Estate Tax (1)
- 233,050	Administrative Cost (5%)
$ 2,697,577	Net Estate to Heirs

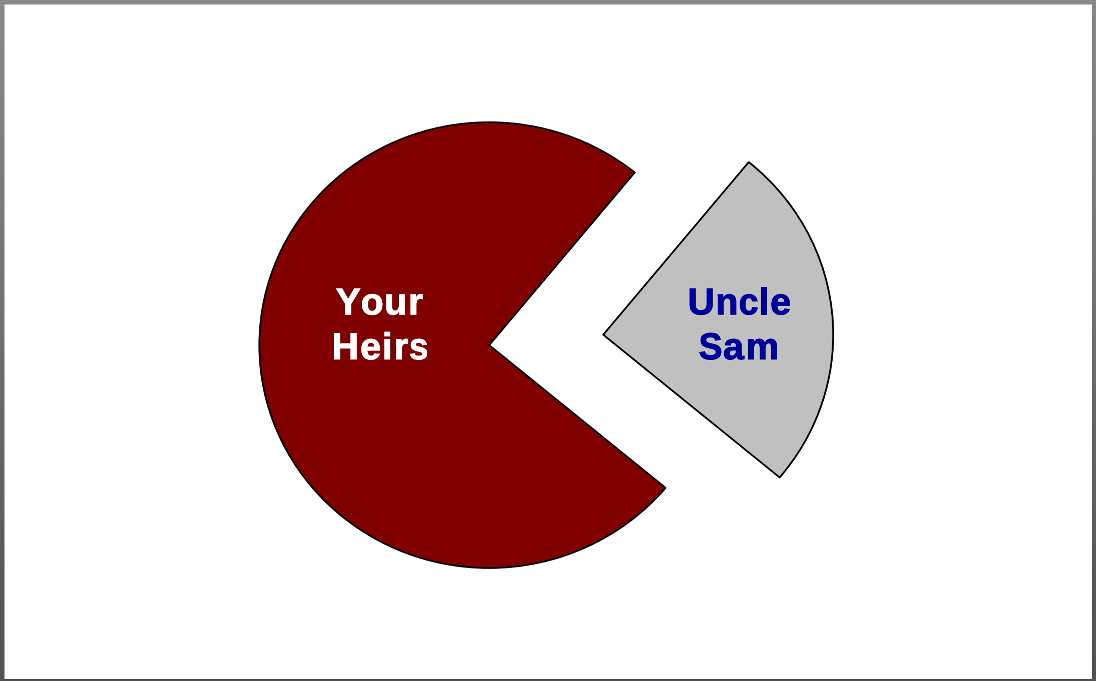
$1,963,423 Total Estate Shrinkage (42%)

(1) Based on the estate reduced by administration costs, on 2001 estate tax rates and a $1 million unified credit equivalent. The Economic Growth and Tax Relief Reconciliation Act of 2001 repealed the estate tax for one year – 2010. Under that law, the federal estate tax continued, but with increasing unified credits and decreasing top estate tax rates, until 2010 when it is repealed only for that year. Without future Congressional action, the 2001 federal estate tax rules will be reinstated in 2011, but with a $1 million exemption equivalent (as scheduled to increase prior to the Act).

A Misconception:

Many people think that when federal estate taxes are payable, Uncle Sam simply takes his slice of their estate "pie," leaving the balance for the estate owner's heirs.

Your Estate



While this result would be bad enough, what actually happens is even worse!

In Reality:

The federal estate tax is a **TRANSFER TAX** imposed on the privilege of transferring assets at death.

The amount of tax payable is measured by the **VALUE** of the assets transferred from the estate to the heirs.

What this means is, while the estate tax is levied on the value of assets transferred, the estate tax **CANNOT** be satisfied simply by transferring a percentage of estate assets to the IRS.

Instead, your estate must pay the federal estate tax in **CASH**, and it generally must pay it in **NINE** months! It may, however, be difficult, if not impossible, to liquidate sufficient non-liquid assets in order to pay the tax in cash.

Estate administrative costs must generally be paid in cash as well.

How difficult would it be to convert

10 PERCENT to 60 PERCENT

of your estate to CASH

in just NINE MONTHS?

Potential Solutions:

There are **FOUR** ways to provide your estate with the liquidity needed to meet its cash obligations.

1. 100% Method

   You could accumulate enough cash in your estate to pay estate settlement costs outright. Rarely, however, does a successful person accumulate such large sums of cash. Instead, the reason for financial success is usually due to the investment of cash in appreciating assets, rather than accumulating it in a bank.

2. 100% Plus Method

   Your estate could borrow the cash needed to pay estate settlement costs. This, however, only defers the problem, since the money will then have to be repaid with interest.

3. Forced Liquidation Method

   Your estate could liquidate sufficient assets to pay estate settlement costs. Keep in mind, however, that a forced liquidation may bring only a small fraction of the true value of your assets if there is not a ready market. In addition, sales expenses are bound to be incurred.

4. Discount Method...

4. Discount Method

Assuming you qualify, you can arrange now to pay your estate tax bill with life insurance dollars. For every dollar your estate needs, you can give an insurance company from approximately one to seven cents a year, depending on your age and health. No matter how long you live, it is unlikely you will ever give the insurance company more than 100 cents on the dollar. In addition, the life insurance policy can frequently be structured to accommodate your unique premium payment requirements.

Ask Yourself...

Does it make sense to pay all of your estate settlement bill from estate assets within nine months of death?

Or...

Does it make more sense to set aside one to two percent of your estate each year now, while you are still in control?

Regardless of your age, it is a fact that using life insurance is frequently the most economical method of providing needed estate liquidity.

What Are the Other Features of Life Insurance in an Estate Plan?

In addition to serving as a source of estate liquidity, life insurance can provide a variety of other features:

- Payment is prompt and certain. Life insurance proceeds are not subject to the time and expense of the probate process.
- The event creating the need for cash -- death -- also creates a source of cash -- the life insurance death benefit. The life insurance policy provides the dollars for a certain need -- estate settlement costs -- that arises at an uncertain time -- death.
- If the death benefit exceeds the total premiums paid, this gain generally is received free of income tax. For example, if only 20 cents of each death benefit dollar received has been paid in premiums, the 80 cent gain is received income tax free!
- The premium payments are spread out and not required in nine months.
- Life insurance avoids all of the problems associated with the other methods for paying estate settlement costs.
- By giving up ownership of the policy, the proceeds may be estate tax free. An attorney can provide you with the popular "Irrevocable Life Insurance Trust" for this purpose, or an adult child can be named as owner.

For these reasons, life insurance is frequently the most economical - and popular - method of providing needed estate liquidity.

Estate Planning Insurance Considerations Action Checklist:

Now…

- [ ] Depending on your situation, complete a total Estate Analysis or an analysis of your Estate Liquidity needs.

- [ ] Purchase life insurance to pay for your estate settlement costs.

  - You may wish to have the insurance owned by an adult child, or by an Irrevocable Life Insurance Trust. Either of these techniques may be able to keep the insurance proceeds out of your estate, if properly implemented.
  - When using a survivorship policy, you may wish to retain ownership in order to use insurance cash values, if needed The policy can be moved out of the estate by giving it away after the first spouse's death. If, however, death occurs within three years of the transfer, the proceeds will be included in the surviving spouse's estate.

Estate Planning Insurance Considerations Action Checklist:

Short-Term…

- ☐ Consult with your attorney to verify that your estate is arranged to take best advantage of the unlimited marital deduction, which allows estate taxes to be deterred until the death of the second spouse. This planning might include use of a Credit Trust provision in your will. This is also known as a Family or a By-Pass Trust.

- ☐ Review current wills and trusts to determine if they will operate as intended under the provisions of the 2001 Tax Relief Act.

- ☐ Review any new insurance policy(ies).

Estate Planning Insurance Considerations Action Checklist:

Longer-Term…

- [ ] Your estate plan, including wills, trusts and life insurance, should be periodically reviewed to ensure that it continues to meet your needs and objectives.

You Can Manage Your Finances…

It's by managing your finances that you write the story of your life. You are both the author and the story's principal character. Resolve to perform what you ought.

Benjamin Franklin