

Estate Planning Insurance Considerations

© 2011 VSA, LP Valid only if used prior to January 1, 2012. The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, neither VSA, L.P. nor The National Underwriter is engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

"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)

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

What Might This Mean to You?

High Cost of Dying

Gross Estate	Administrative Costs at 5% ⁽¹⁾	Taxable Estate	2011 Federal Estate Tax ⁽²⁾
\$ 1,000,000	\$ 50,000	\$ 950,000	\$ 0
5,000,000	250,000	4,750,000	0
7,500,000	375,000	7,125,000	743,750
10,000,000	500,000	9,500,000	1,575,000
15,000,000	750,000	14,250,000	3,237,500
20,000,000	1,000,000	19,000,000	4,900,000
30,000,000	1,500,000	28,500,000	8,225,000

(1) Actual costs may be higher or lower.

(2) Based on the 2011 maximum 35% estate tax rate and \$5 million unified credit exemption equivalent.

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.

What Can Be Learned from Public Probate Records?

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%
Nelson A. Rockefeller	\$ 79,249,475	\$56,727,628	28%
Conrad Hilton	\$199,070,700	\$93,288,483	53%
Source: Public Probate Records			

Consider...

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 and 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 2011, federal estate tax rates begin at 18% and increase to as much as 35% of the taxable value of an estate.

The **federal estate tax** is a transfer tax imposed on the privilege of transferring property at death, while the **federal gift tax** is imposed on the transfer of property during the property owner's lifetime. Both taxes are levied on the **right to transfer property**, and not on the property itself. The amount of tax payable, however, is measured by the value of the transferred property.

The Federal Estate Tax

Once the tentative federal estate or gift tax is determined, it is then reduced by an **estate and gift tax unified credit**. This means that **taxable estates with a value equal to or less than the unified credit equivalent** will not be liable for federal estate tax. The same is true of **cumulative lifetime taxable gifts** which, however, will be brought back into the owner's estate for federal estate tax calculation purposes.

The unified credit equivalent is equal to \$5 million in 2011, meaning that an individual can transfer property valued up to \$5 million, whether during life and/or at death, without incurring a tax liability.

The Federal Estate Tax: Married Couples

A surviving spouse can elect to take advantage of any unused portion of the estate tax unified credit of a spouse who dies in 2011 or 2012.

As a result, with this election and careful estate planning, **married couples can effectively shield up to \$10 million** from the federal estate and gift tax without use of marital deduction planning techniques, but only if one of the spouses dies in 2011 or 2012.

The Federal Estate Tax

Due to a "sunset" provision in the 2010 Tax Relief Act, however, **the current estate and gift tax rules terminate at the end of 2012.** This means that in 2013, without future Congressional action, the federal estate and gift tax rules revert to those in effect in 2001, with a top tax rate of 55%, a \$1 million unified credit equivalent and no "portability" of the unified credit exemption between spouses.

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%
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
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 \$9,487,520 of estate settlement costs (55% estate shrinkage), assuming that no part of the estate growth is consumed.

\$	17,246,000	Taxable Estate
-	862,300	Administration Costs (5%)
-	8,625,220	Federal Estate Tax ⁽¹⁾
<hr/>		
\$	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 exemption equivalent. The 2010 Tax Relief Act provides a maximum 35% estate tax rate, a \$5 million unified credit exemption equivalent and unified credit "portability" for married couples, but "sunsets" at the end of 2012. This means that, without future Congressional action, the 2001 federal estate tax rules will be reinstated in 2013.

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%
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 \$1,963,423 of estate settlement costs (42% estate shrinkage), assuming that no part of the estate growth is consumed.

\$ 4,661,000	Taxable Estate
- 233,050	Administration Costs (5%)
- 1,730,373	Federal Estate Tax ⁽¹⁾
<hr/>	
\$ 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 exemption equivalent. The 2010 Tax Relief Act provides a maximum 35% estate tax rate and a \$5 million unified credit exemption equivalent, but "sunset" at the end of 2012. This means that, without future Congressional action, the 2001 federal estate tax rules will be reinstated in 2013.

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.



**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.

The Question Is...

**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.

Potential Solutions

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

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 provides a variety of other advantages:

- **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.**

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

- **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 deferred until the death of the second spouse, as well as unified credit "portability" between spouses (available in 2011 and 2012). This planning might include use of a Credit Trust provision in your will in order to reflect loss of unified credit "portability" beginning in 2013. 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 both current and possible future estate and gift tax rules.
- 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