

# One Life Insurance Size Doesn't Fit All Estate Planning Situations

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**L**ife insurance has been the key asset associated with estate planning for decades. It is believed that the estate tax has settled down to an individual credit equivalent of \$5.25 million per individual. When an estate has been set up properly, a couple can avoid estate taxes on \$10.5 million of assets. The critical planning device is for each spouse to have at least \$5.25 million in their own name so that regardless of who dies first, their credit equivalent will be fully used.

Life insurance works for estate taxes because estate taxes are due when death occurs—the same trigger that pays life insurance death benefits. But one life insurance size doesn't fit all estate planning situations. Let's go over some common situations.

## Pure Estate Tax Liquidity

Paula, now 64, came to me six years ago. She is single with a son. She owns a fraction of a large apartment

complex. It was decided that approximately \$5 million was a good life insurance amount to cover her estate tax. She also decided to purchase a current assumption universal life (UL) policy to be protected against inflation and have decent cash values. Each year we review her policy and change premiums to keep up with changing interest rates and in case her health changes (it hasn't). She has her estate protected for her son. She could have opted for a guaranteed UL with guaranteed premiums, but she wouldn't be protected against inflation and would have low to zero cash values in case she ended up selling her real estate interest.

## Relatively Large Liquid Estate

Dan and Rita have a large estate with mostly marketable assets. They don't have an estate liquidity issue, but they may want to consider life insurance as a wealth transfer asset. Ideally, they could use a participating whole life policy with increasing death benefits. The premiums could be set based on the annual gift tax exclusions and we could even throw some of their credits into the policy. Life insurance benefits are income tax-free, so they provide excellent income tax planning, and of course, within an irrevocable trust, they aren't included in the estate. Under current financial

conditions, the premiums to death benefit yields at life expectancy are in the 4.5 percent range. Dan and Rita don't need life insurance, but it is usually a worthwhile tax-advantaged asset to use.

## Significantly Large Liquid Estate

Bob and Lois have a situation similar to Dan and Rita, but they should certainly be moving their estate and

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gift tax equivalent amounts (\$5.25 million) out of their estates either to children directly or to an irrevocable trust. If a trust is used, life insurance is a good choice as an investment because of the tax advantages. Participating whole life with increasing death benefits is the way to go. For some reason, clients and many advisers believe it is a good idea to

save the credits. No! Use them as soon as feasible, because it is the growth outside the estate that counts. That is, if \$5 million is gifted (purchasing life insurance with premiums over a period of years, let's say) that has a value of \$8 million at the time of death; \$3 million is out of the estate, and the original gift of \$5 million is brought back into the estate for final accounting. Also keep in mind that if the \$5 million goes down in value, the \$5 million is still the value of the gift, so be careful with what types of assets are gifted.

### Can Term Insurance Be Used?

Term insurance can be used if the need is for a specific period. Let's say our first client, Paula, has a buyout on her real estate investment in 10 years. Using term insurance works fine for this situation. It provides estate tax liquidity in the event she dies within 10 years and is fully liquid when the property is sold and the term is terminated.

### Second Marriage with Older Children from First Marriage

This is a people planning need. It might be good to have a separate life insurance policy for the older children so they don't have to wait around until the second wife dies to inherit any assets.

### Guaranteed UL

Guaranteed UL has been popular with agents and buyers for some time. It guarantees the premiums and death benefits, often to age 120. Usually there is low to zero cash value. The potential problems are if cash values might be needed or if there is a heavy bout of inflation because guaranteed pricing is set. Current assumption ULs are protected from inflation because their crediting rates would likely go up.

### Premium Financing

Do not be talked into premium financing. When insureds live to expectancy, financing of premiums and interest will almost fall apart with an unhappy and expensive termination of the policy. If you can't afford the premiums, buy less life insurance. Although split dollar has become mostly obsolete, I also recommend that it not be used to finance premiums.

### Periodic Reviews for Policies

All policies should be looked at every few years to test the continued creditworthiness of the company, to be sure the policy is properly funded, and to reassess the insured's health.

A particularly disturbing issue has been coming up in my practice. Many policies sold in the 1980s and 1990s mature at age 100, and agents haven't explained this problem well.

If an insured lives to 100, the policy pays out the cash value, although some companies are taking it on their own to continue the policy until the insured dies and pay the cash value as a death benefit.

If the insured is in good health with a reasonable chance of making it to 100, either the policy's premiums need to be changed so the policy's cash value will equal the death benefit at 100, or a new policy should be looked at. On the other end of that spectrum are insureds in poor health who will certainly not come close to 100. They can probably stop paying any further premiums. But regardless of the specific situations, policies need an independent and professional review every few years.

Life insurance is an ideal estate planning asset. Use the right type and use it wisely. ■

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