

## *Uses of Life Insurance in Estate Planning*

There are a variety of uses of life insurance as a tool to solve estate planning problems. The first and most common use of life insurance is to provide money to the survivors of a decedent. Dr. and Mrs. Jones live in a beautiful neighborhood and their three young children all attend the Prodigy Nursery School. Dr. Jones earns \$500,000 per year, but the family has not accumulated any wealth as their living expenses are high and Dr. Jones just paid off his medical school tuition.

Substantial life insurance is required on Dr. Jones to provide Mrs. Jones and their children the funds to maintain their lifestyles. A solution is a large term life insurance policy held in an Irrevocable Life Insurance Trust. If something were to happen to Dr. Jones, in addition to paying any final expenses of Dr. Jones, the trust could be used to provide income to Mrs. Jones, pay the household expenses, pay the tuition for the children and serve as an overall financial security blanket for the family.

### *Liquidity*

A second use of life insurance in estate planning is to provide liquidity. Mr. and Mrs. Smith have a rather traditional estate plan that defers all estate tax until the death of the survivor of them. The majority of their \$5.0 million of property is their \$4.0 million home on Cape Cod that has been in Mrs. Smith's family for years. The remainder of their property consists of tangible personal property, primarily the furnishings of their home, of \$250,000, and investments of \$750,000.

Upon the death of the survivor of the Smiths, there is a federal estate tax liability of \$1.0 mil, but the estate does not have the cash to pay the tax that is due nine months from the date of the survivor's death unless it sells the real estate. This presents two problems. The first, most obvious, problem is that the real estate that has been in Mrs. Smith's family for years has to be sold. Moreover, nine months may not be a sufficient period of time to sell such an expensive parcel of real estate in a vacation location resulting in a sale at less than the optimum price.

The Smiths' problem is easily solved with a life insurance trust that owns a second to die policy of Mr. and Mrs. Smith. Such a structure provides cash when needed, at the death of the survivor of the Smiths and, because the insurance is on both lives, the premiums are substantially less than the premiums would be on the life of either Mr. or Mrs. Smith because the mortality risk is substantially reduced.

### *Wealth Transfer*

A third use of life insurance is to transfer wealth from one generation to another. Mr. and Mrs. Carol were smart enough to cash out of their dot com in 1999 and, as a result, have a great deal of wealth. They know that, in accordance with the annual exclusion from gift taxes, they can only transfer \$22,000 per year to each of their two children, but they want to maximize the wealth transferred to the children and to protect the money from the voluntary and involuntary creditors of the children.

The Carols could make outright transfers to the children, but that would not provide any creditor protection; thus, the transfers must be made to a trust for the benefit of the children. Having solved the creditor protection problem, the Carols now want to focus on maximizing the wealth transferred. Given that the children ages, 2 and 4, they will not need much money in the short term. Moreover, for so long as either of Mr. and Mrs. Carol is alive, all of the needs of the children could be satisfied by them. So long as the needs are for health or education and the transfers are properly made, the satisfaction of the needs will not count towards the annual exclusion gifts to the children.

A potential solution for the Carols is to have the trust, to which the \$22,000 annual transfers are made, own life insurance on the joint lives of the Carols. Having decided to use insurance to transfer wealth to their children, the next question is what kind of insurance to use. I certainly do not have the space to discuss all of one's insurance options, but in the case of the Carols, a traditional whole life policy may be appropriate.

The premiums on a whole life insurance policy are more than for an equal amount of term life insurance because a whole life policy accumulates value. I would search for a policy that would accumulate enough value for the dividends to pay the premiums in about fifteen years. Therefore, in seventeen years, when the children are ready to go to college, the Carols can decide whether to fund the children's educations themselves in addition to their annual funding of the trust, fund the children's education instead of funding the trust (which would continue to pay the life insurance premiums from the policy dividends) or they could fund neither. If the Carols did not fund either, the Trustee could borrow against the policy value and pay both the tuitions and the premiums. Finally, such a vehicle would provide for the needs of the children when the Carols are not alive to do so.

#### *A Word of Caution*

Life insurance comes in as many different varieties as automobiles. More expensive is not always better. The appropriate life insurance product must be carefully selected and I advise considering the source of the recommendation. Life insurance salesmen only make money if they sell policies. Most insurance agents are very ethical and consider only the best interests of the client, but even so they may not be objective due to their proprietary interest. An estate planning attorney, CPA or investment advisor is often objective and can not be compensated when you purchase ANY policy, but be careful. Many professionals have expanded their practices to accept direct benefits from insurance companies. Ask the question.

As always, estate planning is circumstance specific and your plan, and any life insurance involved in your plan, should be carefully tailored to suit your needs. I strongly recommend that you consult an attorney that practices in estate planning.

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