

XI Importance of Life Insurance

Life insurance plays a vital role in the estate planning process. It is instrumental in both conserving and creating an estate. There are four significant reasons why life insurance should be a cornerstone of one's estate plan:

- The proceeds of a life insurance policy are payable immediately following the insured's death
- The proceeds of a life insurance policy are income tax free and estate tax free if properly owned
- Life insurance proceeds payable to a named beneficiary are free from probate administration
- In the large majority of policies written, life insurance proceeds far exceed the premium paid

Regardless of your economic status, there is a high cost to dying and cash is needed immediately. When the breadwinner of a family passes away, the remaining loved ones need financial support. If there has not been the time or opportunity to save the money that will be needed, there will be significant hardships and lost opportunity. A life insurance policy will pay the beneficiary immediately for the amount of insurance on the insured's life. The family will then have necessary money to maintain their standard of living. When purchasing a life insurance policy to create an estate, it is important to know how much is needed. Following are the financial needs of a family that need to be considered

- Funeral expenses
- Any unpaid bills such as credit card debt and medical expenses

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- Attorney and executor fees
- State estate taxes and probate fees
- Paying off the mortgage or setting up a rent fund
- Paying for educational expenses
- Money to pay living expenses
- Money set aside in an emergency fund

Once the financial needs are determined, the following deductions can be taken to calculate the amount of life insurance that should be purchased:

- Existing life insurance already in force
- Social Security benefits
- Pensions that will be received
- The amount of money and investments that have been saved

A professional life insurance agent should be consulted to help in the determination of the amount of insurance needed and what type of policy will best meet the insured's objectives

Individuals that have been fortunate enough to accumulate large estates need sufficient life insurance to provide the liquidity for estate settlement costs. Following are the expenses that must be considered.

- Federal estate taxes which are due nine months after death
- Probate administrative fees
- Attorney and executor fees
- State estate taxes which are due
- Last expenses of the decedent

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- Payment of any unpaid liabilities

Due to the complex nature of these calculations an attorney, accountant and life insurance professional should be consulted

Following are the four main participants in life insurance contracts:

- The *insured* is the person that is covered in the policy. The life insurance proceeds are payable on the death of the insured.
- The *owner* is the person or entity that has all rights of ownership in the policy. No transactions or changes can be made to the contract without the consent of the owner. With the majority of individually owned policies, the owner is also the insured. In policies written on children, business partners and some estate cases, the owner will usually be another entity such as a trust, corporation or other person. When a policy is purchased for the payment of federal estate taxes, the insured should never have any incidences of ownership in the policy, or the proceeds will be includable in their estate.
- The *applicant* is the person or entity that is applying for the life insurance policy. In the majority of situations, the applicant, owner and insured will all be the same person. When it is important that the proceeds are not includable in the insured's estate, the applicant should never be the same person as the insured. It is for this reason, that if a trust is to be the owner and applicant of a policy, then the trust must be in existence prior to the insurance being applied for.
- The *beneficiary* is the person or entity who will receive the policy proceeds upon the insured's death. The owner decides who the beneficiary of the policy will be. There are two different types and classes of beneficiaries

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- *Revocable* - The owner has the right to change the beneficiary at any time
- *Irrevocable* - The owner does not have the right to change the beneficiary
- *Primary* - The primary beneficiary is the first party to receive the insurance proceeds. There can be more than one primary beneficiary listed and the owner can specify what percentage of proceeds each beneficiary will receive
- *Contingent* - If the primary beneficiary is deceased then the proceeds will be paid to the contingent beneficiary. There can be more than one contingent beneficiary listed and the owner can specify what percentage of proceeds each beneficiary will receive

It is always advisable to have more than one class of beneficiaries. If the primary beneficiary is deceased and no contingent beneficiary named, then the proceeds will be payable to the insured's estate which is subject to probate administration. If at all feasible, a minor child should never be named as a beneficiary since no money can be released until the child reaches the majority age. A trust for the benefit of the minor child should be established.

Term Insurance

Term insurance is the least expensive life insurance policy a person can purchase. The insurance provides protection for a specific number of years and does not have any cash value build up. At the end of the term period, the policy expires.

Term insurance should be purchased when a person needs the maximum amount of coverage for the least amount of premium. Term insurance is normally used to cover a temporary need such as the payment of an

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outstanding mortgage or funding a college education in the event of the insured's premature death. When purchasing term insurance, it is advantageous to include the following benefits.

- The *conversion option* gives the owner the right to convert the existing term policy to a permanent policy of the same amount with no evidence of insurability. This benefit is especially important if the insured developed a medical condition which would preclude them from qualifying for additional life insurance coverage.
- The *accelerated benefit* option gives the owner the right to receive a portion of the death benefit while living, if the insured is terminally ill with less than six months to live. The amount received is from 75% to 95% of the death benefit amount. There are some policies which will also pay the proceeds prior to death for an extended nursing home stay. Proceeds received are income tax free.
- The *waiver of premium benefit* will waive any premiums due, if the insured is totally disabled for six months or more

Permanent Insurance

Permanent insurance provides lifelong protection and should be purchased to cover permanent needs such as estate settlement costs and last expenses. For the same amount of coverage, the premium is much more expensive than a term policy. With most permanent policies, the policy remains in force until the insured's death. Unlike term insurance, permanent insurance will build cash value which accumulates on a tax deferred basis which the insured can assess by taking a loan or surrendering the policy. The death benefit is reduced by the amount of any outstanding loan. Following are the four different types of permanent insurance.

- **Whole Life Insurance** - Whole life insurance is the most guaranteed permanent policy which can be purchased. The premium remains

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level over the life of the policy and the policy matures when the insured is 100. At maturity, the cash value will equal the death benefit. Prior to maturity, the policy can be surrendered for the amount of the accumulated cash value. There are two different types of permanent insurance which can be purchased:

- *Participating* - The policy will earn dividends. In addition to the cash value which will greatly enhance the benefits. These policies must be purchased through a mutual or participating company.
 - *Non-participating* - The policy does not earn dividends and the premium is lower than a participating contract
- **Universal Life insurance** - Universal Life insurance is an extremely flexible contract in which the premium is not fixed and the death benefit can be increased or decreased at any time according to the provisions of the contract. Upon an increase in death benefit, the insured must provide evidence of insurability. The policy is comprised of two components, the cost of the insurance and the contract fund. The amount of the premium paid minus administrative costs is deposited into the contract fund which will earn a stated rate of interest. Each month, the insurance company will deduct the cost of the insurance from the contract fund. The cost of the insurance is based on what a comparable term policy would have cost. If there is sufficient cash in the contract fund, the insurance will continue to be in effect. If the contract fund does not have the necessary funds to pay the cost of the insurance, the policy will lapse. Unlike whole life insurance, there is no guarantee that the policy will be in force at the time of death. When purchasing a universal life contract, always make sure that the premium paid is sufficient to pay the costs of the insurance now and in the future and pay very close attention to the annual statement on how the policy is performing.

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- **Survivorship Life Insurance** - Survivorship whole life insurance (also known as second-to-die life insurance) is a single policy which covers two named insureds, but the death benefit is payable only on the death of the survivor. Since it is a single policy and only one death benefit is payable, a second-to-die policy costs less than separate policies on each insured. This policy is basically used in large estate planning cases. As discussed, there is no federal estate tax upon the death of the first spouse, since all assets can transfer tax free due to the unlimited marital deduction. Taxes will be owed on the death of the surviving spouse which is when the policy pays the death benefit. Ownership of the policy should always be another entity other than the insureds, so the proceeds will not be includable in their estate. A life insurance irrevocable trust is quite often the owner, beneficiary and applicant of this type of policy.

When purchasing permanent insurance it is advantageous to include the following benefits.

- The *accelerated benefit* option gives the owner the right to receive a portion of the death benefit while living, if the insured is terminally ill with less than six months to live. The amount received is from 75% to 95% of the death benefit amount. There are some policies which will also pay the proceeds prior to death for an extended nursing home stay. Proceeds received are income tax free.
- The *waiver of premium* benefit will waive any premiums due, if the insured is totally disabled for six months or more

Life insurance costs pennies on the dollar, offers tax deferred build up of cash value and the proceeds are payable income tax free without being probated. There is no better way to pay an individual's estate settlement costs and last expenses.

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Estate planning is essential for each and every one of us. Spending the time and energy to properly plan for your estate today, has far reaching implications for the ones you love tomorrow.