Life Insurance Cuts the Cost of Higher Estate Taxes

A classic strategy becomes one of the best ways to address looming tax reform challenges.

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The strategy is not new, but with the potential demise of many of the other great estate planning strategies, the use of life insurance could again become one of your client's best options. This article is a reminder of how it can help your clients, how it is generally priced, and things to consider as you take on the biggest changes to tax law many of us have seen in our lifetime.

At its core, the use of life insurance is simple. After planning away as much of the taxes anticipated upon our client's death, you then turn to addressing how that projected tax bill will be paid. You will likely begin with whether there is sufficient projected liquidity in the estate to cover taxes and, if so, whether the family can bear the loss of those assets to the government. The life insurance option will be a great way to address the problem. It works this way: your client pays smaller amounts while living so that upon his or her passing there will be a fund to pay the taxes and spare the estate a major liability. Traditionally, the premiums are paid to a trust which owns the life insurance. The premiums are paid with the gift tax rules in mind, but the death benefit totally escapes income and estate taxes.

Given the likelihood that clients will live longer than the availability of most term insurance, we regularly use cash value coverage designed to remain in force for the expected lifetime of the insured, with some margin thrown in. Most policies can last to age 120 and beyond, so duration can be quite sufficient. Of course, your client must be insurable, but we have found that many more people are insurable than advisors might think. Carriers will often make exceptions in the right circumstances, and AdvisorServe works very hard to create those right circumstances. We often help present the best case to the carriers, making certain that the no favorable medical evidence is ignored or excluded.

Having narrowed down our carrier selection to only those who will offer coverage at attractive prices to a client based on his or her health, we then address which type of permanent policy will best fit the client and what type of coverage will best fit the planning. This may include whole life, universal life, indexed policies, variable policies, and policies with guarantees extending to a particular age.

Just in case you wonder what permanent life insurance might cost, we have set forth below a chart as a guide. While these numbers are a starting point, we will always try to find a better rate. The amount of coverage illustrated is $1,000,000 for a competitive cash value product assuming a preferred client who does not smoke. We are showing the funding in two ways: 1) on a lifetime full pay basis, and 2) using a shorter 10-year period to fund the coverage.

Age	Premium	Duration
Male, 55	$12,000	full pay
Male, 55	$22,500	10 yrs.
Male, 65	$21,000	full pay
Male, 65	$36,000	10 yrs.
Male, 75	$43,500	full pay
Male, 75	$63,000	10 yrs.
Female, 55	$10,500	full pay
Female, 55	$20,000	10 yrs.
Female, 65	$18,250	full pay
Female, 65	$31,736	10 yrs.
Female, 75	$37,100	full pay
Female, 75	$56,000	10 yrs.
M and F, 55	$ 7,800	full pay
M and F, 55	$16,000	10 yrs.
M and F, 65	$14,000	full pay
M and F, 65	$26,000	10 yrs.
M and F, 75	$27,100	full pay
M and F, 75	$44,000	10 yrs.

The last grouping of prices is for policies known as "survivorship" or "2nd to die". They pay on the second death of a husband and wife, when the taxes are normally due. As a result, they are less expensive. The planning controls how an advisor decides which coverage is best. Some may prefer to have a death benefit upon the first death, so that there will be funds for the survivor or so that certain transactions can take place early. Also, only one of the clients may be insurable. However, we see situations where survivorship coverage works better, even if one of the insureds is uninsurable (sometimes shown as Table Z, the highest rating).

The whole point of this is to give you, the advisor, a starting point when you consider where life insurance could help in your planning. In our experience, the economics can be quite compelling. Let's take the clients who are both 65 years old. You will see that the annual cost of survivorship coverage is projected to be around $14,000 per million, on a full pay basis. That's only 1.4 cents per dollar of coverage. To say it another way, the clients would have to live another 72 years before they would have lost on the life insurance bet. Certainly, there is a time value of money involved here. If we were to put a rate of return on premium at life expectancy, and I will use age 92 as my reference point. For two 65-year-olds, the internal rate of return on paying $14,000 per year for a $1,000,000 death benefit at age 92 is 8.13%! This may sound modest, but considering the 8.13% is free of income or capital gains taxes and can be free of estate taxes makes it a very attractive rate of return.

Please remember that these are only rough examples. The type of coverage, health rating, carrier, assumptions used, and policy duration, will all have an impact on the ultimate cost of coverage. And we used the $1,000,000 amount to make it easy to scale this chart to the actual needs of your clients. Thus, $10,000,000 should run around 10 times the cost shown in the chart, with minimal if any adjustment for "volume pricing".

We believe that life insurance will be an essential element of your planning for families as they address the impact of either today's more attractive tax law or the proposed tax provisions that could become the law of the land by the end of this year.

It is our expectation that life insurance applications will pick up if tax reform takes anything close to the form that is being proposed. That will cause more pressure on life insurance companies to keep up with demand. It may also give the life insurance companies good reason to be less flexible in accepting extra risks. And we will still need to wait for doctors to submit their files, which already slows the underwriting process.

Our best advice is to begin conversations with your clients early. This is the perfect time to ask clients to fully develop their charitable objectives, amounts they want to leave to their children, and the taxes they can afford to pay.

That groundwork will be critical when the actual provisions are enacted and you face the inevitable year end rush to rebuild estate plans.

AdvisorServe can also help you set up the underwriting early and efficiently, so that clients don't have to wait more than necessary for carrier decisions. If any of your clients are likely candidates for more life insurance, we can help build the files needed for underwriting now, including the time-consuming acquisition of necessary medical files. Ultimately, we want to help you have access to the most accurate pricing information and fully support you through implementation of any coverage you want for your clients. This may also involve working with the client's attorney to complete documents and re-set the estate plan.

In a future article, we will address alternate methods of funding the premiums. Both family split dollar and premium financing can reduce the share of premiums that is impacted by gift taxes. In the right situations, these alternate approaches can leverage the results or at least reduce the impact of premiums.

The proposed changes in tax law may present your clients with one of the greatest threats to their family legacy we have seen in our lifetimes. As advisors who fully understand those changes and who present sound solutions, you can be the very heroes your clients will need in the months ahead. AdvisorServe is ready to be your resource for ideas, advice and support whenever insurance solutions play a role in your work.