John Hancock
INSURANCE

ADVANCED MARKETS

BECAUSE YOU ASKED

Planning During Uncertain Times

With a Republican-controlled House and Senate, and a newly elected President who campaigned for estate tax repeal, it is not surprising that many question whether the estate tax is here to stay. While the path to a complete, permanent repeal is by no means a sure thing, it is important to remember the importance of estate planning and the role that life insurance plays in the estate planning marketplace.

What are some of the non-tax reasons for estate planning?

Estate planning is much more than just estate tax planning, even for high-net-worth families. Consider some of the reasons below for why clients will still want to engage in estate planning:

1. ESTATE PLANNING HAS ALWAYS BEEN ABOUT MORE THAN ESTATE *TAX* PLANNING

First and foremost, estate planning is about making sure that clients' wishes are properly executed at their death. Regardless of any estate tax considerations, clients should work with their attorneys to execute proper legal documents. Estate planning documents such as wills, trusts, health care proxies, and power of attorneys are at the core of a basic estate plan and help to ensure that a client's goals and wishes are fulfilled during incapacity and/or upon death.

2. CONTROL

One of the most effective ways to control assets from "beyond the grave" is to place those assets into trust. Many clients wish to distribute wealth in specific intervals over a period of years. For example, a client may have a minor child that they would like to receive the money over the course of his or her lifetime. Alternatively, the client may wish to have only income distributed to the child with the remainder passing to future generations. Trusts can be drafted to provide specific dispositive language based upon the grantor's unique goals.

3. CREDITOR PROTECTION

Clients who have worked hard to grow their net worth understandably want to preserve their estate from attacks by creditors, including bankruptcy and divorce. By creating an irrevocable life insurance trust (ILIT), clients can protect assets from these outside creditors.

4. BLENDED FAMILIES

Modern families come in all shapes and sizes, including the "blended" family that combines several family groups into one, e.g., a new spouse, young children born out of a second marriage, children from a previous relationship, etc. Clients in blended families have the same broad concerns: making sure their loved ones are taken care of both during life and at death. However, because of the potential for age discrepancies and concerns regarding the deterioration of relationships among blended family members after a client has passed, trust planning may play a key role in providing for heirs and maintaining harmony.

5. SPECIAL NEEDS

The care of a family member with special needs can often be a significant concern for clients. Although the task of planning for the ongoing support and care of a loved one may be daunting, proper estate planning is crucial to ensure that a special needs beneficiary receives the highest level of care and living standards in the future. A special needs trust can provide for current and/or future specialized care needs while preserving access to government benefits.

6. STATE ESTATE TAXES

For clients who reside in a state that imposes a state estate or inheritance tax, trust planning will still play a large role in ensuring that these taxes are handled as efficiently as possible. For more information, see our BYA on State Estate Taxes.

Why use life insurance in estate planning?

Conversations about estate tax planning and life insurance often go hand-in-hand. In the high-net-worth space in particular, life insurance has historically been an attractive asset to own to help pay for estate taxes and provide estate liquidity. In an estate-tax free world, life insurance would still play an extremely valuable role in part of a high-net-worth client's overall estate plan.

There are many reasons to own life insurance that are not related to estate taxes. Most notably, life insurance provides protection for your clients' families in the form of an income tax free death benefit and income replacement. Moreover, riders can protect against disability and long-term care costs. Consider below some of the ways that clients, particularly in the high-net-worth space, may benefit from ownership of a life insurance policy.

1. LIQUIDITY

A life insurance death benefit can provide liquidity at a time when it is needed most: to pay final expenses such as funeral costs, capital gains and income taxes, and to settle the estate among all beneficiaries. Income taxes, particularly capital gains taxes, may become a more pressing problem if the estate tax law is repealed as many commentators predict that repeal of the estate tax would also mean the end of step-up in basis treatment of assets at death.

2. INVESTMENT OPPORTUNITY AND TAX EFFICIENCY

Life insurance proceeds are generally received income tax free. This may allow the beneficiaries of the policy to receive a higher rate of return on the premiums paid when compared to the return on a taxable asset. Additionally, life insurance policy cash values grow tax-deferred and can be accessed in a tax-favored manner. When life insurance is owned in an irrevocable trust, the tax efficiencies of life insurance become even more valuable, especially considering that trusts have condensed marginal income tax brackets that tax income at the highest marginal brackets at very low income thresholds.

3. ESTATE EQUALIZATION

Estates can be made up of various assets, some of which are harder to divide than others, such as business interests, real estate, and art collections. Consider an example where a client's estate is largely comprised of interest in a commercial real estate business. One of the client's two children actively participates in the business; the other is uninvolved. Leaving the real estate to the former child might make good sense from a practical standpoint, but would leave the latter child in an unequal position. A trust funded with life insurance can provide needed funds to equalize an estate among all beneficiaries and ensure equity amongst all heirs. This type of proactive planning can create harmony and peace in a family long after an individual has passed.

4. BUSINESS PLANNING NEEDS

For many high-net-worth clients, some or all of their estate may be comprised of business interest(s). Life insurance can provide a funding source for a buy-sell arrangement to ensure a timely and smooth transition from one business owner to another. Without life insurance, the business and/or the surviving owners may not have the necessary liquidity to buy out the estate, which could put the decedent's family's financial stability in jeopardy or could result in the decedent's heirs having an unexpected continued interest in the business.

5. SUPPLEMENTAL INCOME NEEDS

The cash value of a permanent life insurance policy may help supplement income needs. Traditionally, cash value life insurance has been viewed as a supplemental retirement vehicle, which unlike traditional retirement accounts, may be accessed without any pre-59 ½ penalties or RMDs, and there are no contribution limits. But, cash value can be used for much more than just supplementing retirement income; for example, distributions can be taken to help fund higher education costs or to purchase a second home. The key to a permanent policy is that in additon to the death benefit, there is flexibility when making cash value distributions and these distributions can generally be accessed in a tax efficient matter.

6. BLENDED FAMILIES

Life insurance can be used to equalize an inheritance in a blended family to help avoid family discord at death. For example, proceeds from insurance could be left to children from a prior marriage, to ensure that these children do not have to rely upon a surviving step-parent in order to inherit.

7. LEGACY

Life insurance not only can enhance the legacy that clients will leave to their loved ones, but also can provide a protective inheritance should the insured (or insureds) spend down more of their estate during life than originally planned.

8. INSURABILITY

When it comes to politics, nothing is ever truly "permanent." Even if estate tax repeal is successful, there is no guarantee that the next administration will not reinstate the tax. As clients grow older their health may deteriorate, so it may make sense to lock-in insurability now rather than wait to see what may or may not happen in the future.

Conclusion

Estate planning and life insurance planning is about so much more than estate taxes. Regardless of the political environment, it is imperative that clients continue to engage in planning to ensure that their wealth and legacy goals are met. The key is to plan for today, but implement a plan that is flexible enough to meet changing circumstances and needs. The value proposition of life insurance has always been the same — to protect those we love and ensure that our legacy is fulfilled. Permanent life insurance can provide flexibility, offer a tax efficient death benefit and access to cash value, and may provide supplemental income. John Hancock has been a leader in this industry, with innovative products and solutions to help many clients in all phases of life. With more Americans underinsured, now is the time to talk to your clients about their need to protect all that they have and love.