

Three Rules You Should Know

It's Your Money
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You've heard the saying, "The three rules regarding the value of real estate are location, location and location".

Life insurance is like that. If you want to keep it out of your taxable estate, the three most important rules are ownership, ownership and ownership.

Assume you purchase a \$1 million life insurance policy on your life and name your children as the beneficiaries. The agent tells you that since your children are the beneficiaries, the \$1 million death benefit won't be included in your taxable estate. "Besides", says the well intentioned, but poorly educated agent, "you want to keep access to the cash values. So you should be the owner."

Oops! You may have just given the IRS a \$450,000 gratuity.

Here's the basic rule: If you own life insurance, or even have limited control over it, the policy's death benefit is included in your taxable estate.

Disobey these rules and you could lose nearly 50% of your life insurance policy's death benefit to estate taxes.

The Internal Revenue Code goes so far as to say that if you possess any "*incidents of ownership*" the policy is taxed in your estate. If you retain (among others) the right to change the beneficiary, cancel the policy, or obtain a policy loan, you have an "incident of ownership" and that is enough to pull the entire death benefit back into your taxable estate. With estate tax rates topping out at 45%, you can see the hazard. The very asset you have purchased to help pay estate taxes, **increases your taxes!**

I don't want to confuse, but in certain circumstances it is wise to personally own your life insurance notwithstanding what is written above. If you are uneasy about how your life insurance is owned, see "What should I do next?" below.

Double OOPS!

My pet peeve is a taxable estate where the husband owns life insurance on his wife, and the wife owns life insurance on her husband. Think about it. The husband dies and the wife receives her husband's death benefit. Since the husband has died, he can no longer own the policy on his wife's life, so ownership of her policy may (depending on the contingent ownership designation) revert to her. Later when the wife dies, the proceeds of both policies wind up in her taxable estate. Unfortunately, this cross-ownership between spouses has been widely practiced.

What should I do next?

Start with at least two experienced advisors. Find an attorney and a life insurance agent who specialize in estate planning. Review your life insurance policies and financial plans with these experts. If you lack confidence in the agent who originally sold you the insurance, you may want to go to a new advisor for a second opinion.

There are many constantly moving parts in an estate plan. The value of your estate, the tax laws, and even your life insurance policy itself may change dramatically over time. So even if you paid a bundle to set things up, it is essential that your plan be reviewed periodically.

Proper ownership creates POWERFUL leverage!

Life insurance can be a powerful tool in your estate plan. If properly structured, the death benefit can be received estate-tax-free and income-tax-free by your heirs. But to accomplish these goals, it is often necessary to establish an irrevocable trust that owns the policy. It costs money to create a trust, but buying good advice is like the price of seed to a farmer.

Some folks are a little frightened by the word “irrevocable” when planning a trust. Unfortunately, it is the scary word that provides the tax savings.

Taming the “Irrevocable” Monster

Some attorneys create the position of “Trust Protector” in the irrevocable trusts they write. The Trust Protector is usually a non-family member who is given the authority to modify particular trust provisions as time goes on. Behold! the irrevocable trust becomes flexible. The position of Trust Protector cannot be added to an existing trust, it must be created in the original trust document.

Want to impress your attorney the next time discussion turns to irrevocable trusts? Simply say, “Shouldn’t I appoint a Trust Protector?” I think you should. After all, It’s Your Money.

Verlyn De Wit helps successful dairy producers make smart decisions about their money. He can be reached toll-free at 1-888-468-1728 by email at vdewit@sammonsrep.com or “snail-mail” at 1270 Eastside Dr., Sioux Center, IA 51250. Securities offered through Sammons Securities Co., LLC. 4261 Park Road, Ann Arbor, MI 48103. Member FINRA and SIPC.

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