“Life” after ATRA

(The American Taxpayer Relief Act)

Presented By Roy Cranman, Sales Vice President
Accredited Estate Planner
Chartered Life Underwriter
Chartered Financial Consultant
Capitas Distributors, Inc./Capitas Financial

Securities offered through The Leaders Group, Inc. Member FINRA/SIPC,
26 W. Dry Creek Circle, Ste. 575, Littleton, CO 80130 (303)797-9080.
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- We will cover Recent Changes under ATRA and other legislation
- We will explore what opportunities have been diminished by ATRA
- We will explore a significant opportunity for HNW clients that was created by ATRA
- We will look at new opportunities advisors can consider for their clients

Today's Discussion

Estate Tax Highlights of ATRA & Other Recent Legislation

- 2010 Estate Tax rules were extended.
  - $5,250,000 lifetime exemption per person
  - Portability of exemption between spouses
  - $14,000 annual exclusion
  - $5,250,000 GST exemption
  - 40% tax rate
- Conclusions:
  - Far less people will be subject to estate taxes.
  - Very likely that many people of moderate wealth will feel less urgency to prepare for the transfer of wealth to their heirs.
  - The number of opportunities where life insurance is needed to provide estate liquidity will be significantly reduced.

Highlights of ATRA & Other Recent Legislation

- Income taxes were increased.
  - Top federal income tax bracket increased to 39.6%
  - Medicare surtax of 3.8% for high income earners (HIE)
  - Phase-out of exemptions and itemized deductions increases for HIE.
  - 0.9% Medicare tax on wages for HIE
  - Maximum capital gains/dividend rate increased to 20%
  - Depending on state of residence, some taxpayers could be paying above 50% in taxes.
- Conclusions:
  - Going forward planning may be focused more on income tax saving techniques than estate planning.

What does it all mean? Insurance & Financial Advisors will need to:

- Convince their clients of the continuing need for estate planning to:
  - Protect assets from vulnerable surviving spouses & heirs, creditors, predators, in-laws and out-laws
  - Protect against transfer taxes on future growth of assets
- Convince their clients of the continuing need for life insurance to:
  - Focus more on non-estate tax needs and more on liquidity for business succession, asset preservation (Life w/LTC riders), equalization for blended family planning & to maximize wealth transfer with minimal risk.

What does it all mean? Insurance & Financial Advisors may need to change their focus to:

- Income tax saving techniques rather than estate planning.
- Continued low interest rates may shift the focus from lifetime guarantees & low premium, low cash value life products to products with more modest guarantees and higher tax deferred cash values.
- *Life Insurance as an Asset Class* could become a more prevalent theme as the attractive IRR on life policy death benefits will offer exceptional alternatives with continued low interest rates

Let’s look at Three Sample Cases:

1. For those who are still looking for the large estate planning opportunities.
2. For business planning opportunities.
3. For wealth maximization and protection opportunities.

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The Facts:

- **Sal Monella** and his wife **Mary** (both are age 65) own a very successful Italian canning business. Two of there three children work with them and will likely take it over after they retire. The third child is an inner city social worker who loves her work but has difficulty making ends meet. Sal & Mary earn about $500,000 per year in salaries.
- Last December, on the advice of his CPA and tax attorney Sal created an irrevocable spousal lifetime access trust (SLAT) for Mary's benefit during her lifetime with their children as remainder beneficiaries. Sal, as the grantor, gifted $5,250,000 of cash and securities to the trust. Sal & Mary do not expect to need any of the income or assets in this trust during their remaining lifetimes. Their children are co-trustees. Sal plans to reinvest the dividends and capital gains on those assets.
- He continues to own 100% of his restaurant's S-Corp stock worth approximately $3,500,000 along with his home worth $500,000 and his & Mary's IRA's valued at $1,000,000.
- Certainly there are additional planning opportunities to reduce their future estate tax liability, but those are the subject of a future discussion.

Comparison: Reinvesting Trust Earnings vs. Using Them to Purchase Last Survivor Life Insurance

Assumptions	
Federal Tax Rate:	20%
Federal Medicare Tax:	3.8%
GA Income Tax:	6%
Comb. Effective Tax Rate:	28.37%
8% Gross ROR less 1% in fees :	7.00%
Net A/T ROR:	5.00%
Trust Value BOY:	5,250,000

		Reinvest	Use Trust Earnings to Purchase Insurance*			
Year	Age	Trust Value EOY	Trust Value	Policy DB	Total Value	Advantage
1	66	5,250,000	5,000,000	35,000,000	40,000,000	34,750,000
2	67	5,532,043	5,000,000	35,000,000	40,000,000	34,467,957
3	68	5,829,238	5,000,000	35,000,000	40,000,000	34,170,762
4	69	6,142,400	5,000,000	35,000,000	40,000,000	33,857,600
5	70	6,472,385	5,000,000	21,000,000	26,000,000	19,527,615
6	71	6,820,097	5,000,000	21,000,000	26,000,000	19,179,903
7	72	7,186,490	5,000,000	21,000,000	26,000,000	18,813,510
8	73	7,572,566	5,000,000	21,000,000	26,000,000	18,427,434
9	74	7,979,383	5,000,000	21,000,000	26,000,000	18,020,617
10	75	8,408,056	5,000,000	21,000,000	26,000,000	17,591,944
15	80	10,922,621	5,000,000	21,000,000	26,000,000	15,077,379
20	85	14,189,207	5,000,000	21,000,000	26,000,000	11,810,793
25	90	18,432,718	5,000,000	21,000,000	26,000,000	7,567,282
30	95	23,945,321	5,000,000	21,000,000	26,000,000	2,054,679

** Sample Policy: Survivorship UL Preferred Male & Female NS. $250k annual premium payable to age 95.*

The Facts:

- Twin brothers Billy & Ricky Bob own a successful auto repair & tire store. They are age 45 and in excellent health.
- They are both married and each earn $200,000 in total salary and K-1 income.
- They are contributing the maximum allowed to their respective 401(k) plans. They each want to contribute $35,000 (a/t) more but cannot due so due to qualified plan contribution limitations.
- Both live modestly and are concerned that the drag of income taxes are significantly affecting their savings results.
- They were recently offered $2,000,000 by a national chain for their business but, they have a very loyal customer bases and have no interest in selling at this time.
- Both plan to retire in their mid to late 60s.
- They have no Buy-Sell agreement
- They have no Long Term Care protection

Disability income coverage is beyond the scope of this discussion.

Solution:

- Billy & Ricky establish a buy-sell partnership that initiates the purchase of shares from the first deceased brother or the first to become **chronically ill**.
- Initially, they each agree to contribute $35,000 per year to the partnership.
- The partnership purchases a $1,000,000 guaranteed (for life*) VUL policy with a $35,000 annual premium on each of them.
  - The maximum non-MEC premium is ≈ $45,000, leaving them room to increase premiums.
- At the death of a shareholder the partnership is required to distribute the policy death benefit proceeds to the surviving partner who must use them to purchase the deceased shareholder's interest.
- Each policy includes an accelerated death benefit rider for chronic illness that pays up to 2% per month of the death benefit to the policy owner (the partnership) once the rider qualifications are met.
  - Should one of the shareholders become chronically ill, the partnership is required to distribute the policy proceeds to the other partner who must use them to purchase the chronically ill shareholder's interest.
  - Because it is an indemnity based rider the benefits should be tax free to the policy owner subject to IRS guidelines & Limitations.

**VUL is governed by AG37 rather than AG38 so we may begin to see longer guarantees on them*

Solution Continued:

- At retirement, assuming the business is sold to a third party, the partnership should be able to distribute their respective policies to each shareholder tax free without any adverse income tax consequences.
- Based on an 8% assumed ROR and current tax laws, beginning at age 68, the VUL policies are projected to provide them with over $100,000 of tax free income annually for their remaining lives.
- Investing individually, assuming an 8% gross ROR, 1% in management fees and a 37% effective marginal tax bracket, they will:
  - Accumulate less money by their retirement.
  - Run out of money by age 88.
  - Have no death benefit or chronic illness coverage.
- It's not about how much money you earn, but rather how much you keep.

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Facts:

- Junior Sample and his wife Minnie are ages 70 & 67. Junior has had numerous medical problems and is uninsurable.
- They have 2 children and one grandchild who they adore. They want to leave as much of their assets to their children as possible.
- Junior & Minnie have social security and rental income totaling about $50,000/year. Junior also has a small pension of $12,000/year, net of taxes, which they are saving.
- Their assets include:
  - IRAs worth $150,000 – They do not need their RMD's at this time.
  - Liquid investments, conservatively invested, of $100,000
  - Rental Property worth $125,000
  - CDs totaling 250,000
- They are concerned about their long term care exposure, especially with Junior's health and have no LTC coverage. The can probably weather one LTC storm, but two would surely wipe them out, leaving nothing for their kids.
  - They considered purchasing LTCi coverage on Minnie but decided against it because if they never used it, the $5,100 annual premium would be lost forever and not go to their kids.
  - Currently they plan to use the $250,000 in CDs for LTC.
- Total assets available, assuming neither of then has an LTC event: $625,000

Possible Solution:

- Use $12,000 per year of their excess income to purchase a $500,000 life policy on Minnie with a 2% ($10,000/month) LTC rider.
- Together with their other assets, this gives them over $1,125,000 in assets to use for possible LTC expenses and/or leave to their children.

Note: The LTC policy they considered was for a $5,000/month benefit for 4 years. It had no inflation riders. Therefore, it provided total benefits of $240,000. A policy with a $500,000 policy limit would have cost the Samples over $10,000.

- Old Credit Shelter Trusts
- Split Funded Defined Benefit Plans
- LIRPs: **L**ife **I**nsurance **R**etirement **P**lans
- Asset Replacement due to investment losses
- Immediate Income Annuities coupled with wealth replacement life insurance. It increases a client’s cash flow preserves their wealth.

Other Opportunities

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Questions????

Final Thoughts