Protective

Estate tax concepts

Estate liquidity

The problem

- When a person dies, taxes and other costs must be paid promptly—in cash—within a short period following the date of death.
- These taxes and other expenses deplete the estate to be received by the heirs.
- Typical costs may include federal and state estate taxes, funeral expenses, the costs associated with the estate owner's last illness, outstanding debts, and probate costs (including executor's fees, attorney's fees, court costs, appraiser's fees, costs of insuring estate property, and more).
- In planning for sufficient estate liquidity, an individual should first estimate these costs, then find the means to provide for their prompt payment.

The response

- Comprehensive estate preservation strategies must provide for the orderly disposition of estate assets, while making certain the estate executor will have ready cash to pay estate obligations promptly.
- Life insurance is a tool commonly used to ensure that the estate has sufficient cash to satisfy the claims of creditors and pay taxes and other costs that result when an estate owner dies.
- Individuals whose estates may be subject to federal estate tax can arrange the life insurance benefits so that the proceeds will not be included in the gross estate.

The life insurance advantage

- Life insurance proceeds are available immediately at death, just when they are needed.
- When properly arranged, life insurance proceeds are received free of federal income tax.
- Policy ownership can be arranged so the proceeds avoid probate and are not included as part of the federal estate tax calculation.
- The immediate availability of sufficient proceeds ensures that the estate can avoid liquidating other assets to pay estate costs.
- The estate also avoids the need to borrow at interest or pay the federal estate tax in installments (if this option is available).
- Life insurance proceeds almost always surpass the cost of all premiums paid for the policy, which means estate costs are being funded at a discount.

The bottom line

A sound, regularly updated estate review serves two key purposes—arranging for the orderly disposition of estate assets, and protecting the estate from needless taxation and shrinkage. Life insurance can be a key component of a plan that creates necessary liquidity to pay estate obligations when the need arises without depleting estate assets intended for the heirs.

Summary

The liquidity problem

When a person dies, taxes and other costs must be paid promptly and in cash. If arrangements haven't been made to anticipate these expenses, an estate can be severely depleted.

There is a long list of potential expenses associated with an individual's death, including:

- Federal and state estate taxes
- Funeral and burial expenses
- Unpaid medical expenses
- Debt—mortgages, credit card debt, car loans, etc.
- Executor's fees
- Attorney's fees
- Court costs
- Appraiser's fees
- Costs of insuring and otherwise protecting estate property

Some people think they can rely on marketable securities to meet these estate liquidity needs. However, if the individual dies before accumulating a sufficient portfolio, or if the market is down at the time of death, the executor may not have the cash needed to meet estate liquidity costs and may have to sell assets at sacrifice prices, resulting in a dramatic reduction in the wealth that was intended for the heirs.

Solving the liquidity problem

A comprehensive estate strategy prepared in advance can provide for the disposition of an individual's assets and also ensure that the executor has the cash needed to pay estate obligations in a timely manner. This avoids the forced sale of assets and potential estate shrinkage.

Life insurance can provide the estate with the necessary cash to satisfy the claims of creditors, pay taxes and other costs, and avoid forced liquidation of assets. This gives the individual peace of mind knowing that the necessary liquidity will be available right when it's needed.

Life insurance advantages

Life insurance offers other advantages, as well. For individuals whose estates may be subject to the federal estate tax, life insurance can be arranged so proceeds are not included in the gross estate. Consider the following advantages:

- Proceeds usually are received free of federal income tax.
- Cash from the proceeds helps the estate avoid a forced liquidation of assets, often at sacrifice prices.
- The estate can also avoid borrowing, eliminating the interest charges associated with a loan.

- The immediate availability of cash to pay settlement costs avoids the need to pay the federal estate tax in installments (with interest).
- A life insurance policy almost always returns substantially more in death proceeds than was paid in premiums, allowing estate costs to be funded at a discount.

Conclusion

A sound estate plan that is updated regularly serves multiple purposes. It arranges for the orderly disposition of estate assets at death and protects the estate from needless taxation and shrinkage. Life insurance plays a critical role by creating liquidity to pay estate obligations when the need arises—without depleting assets intended for heirs.