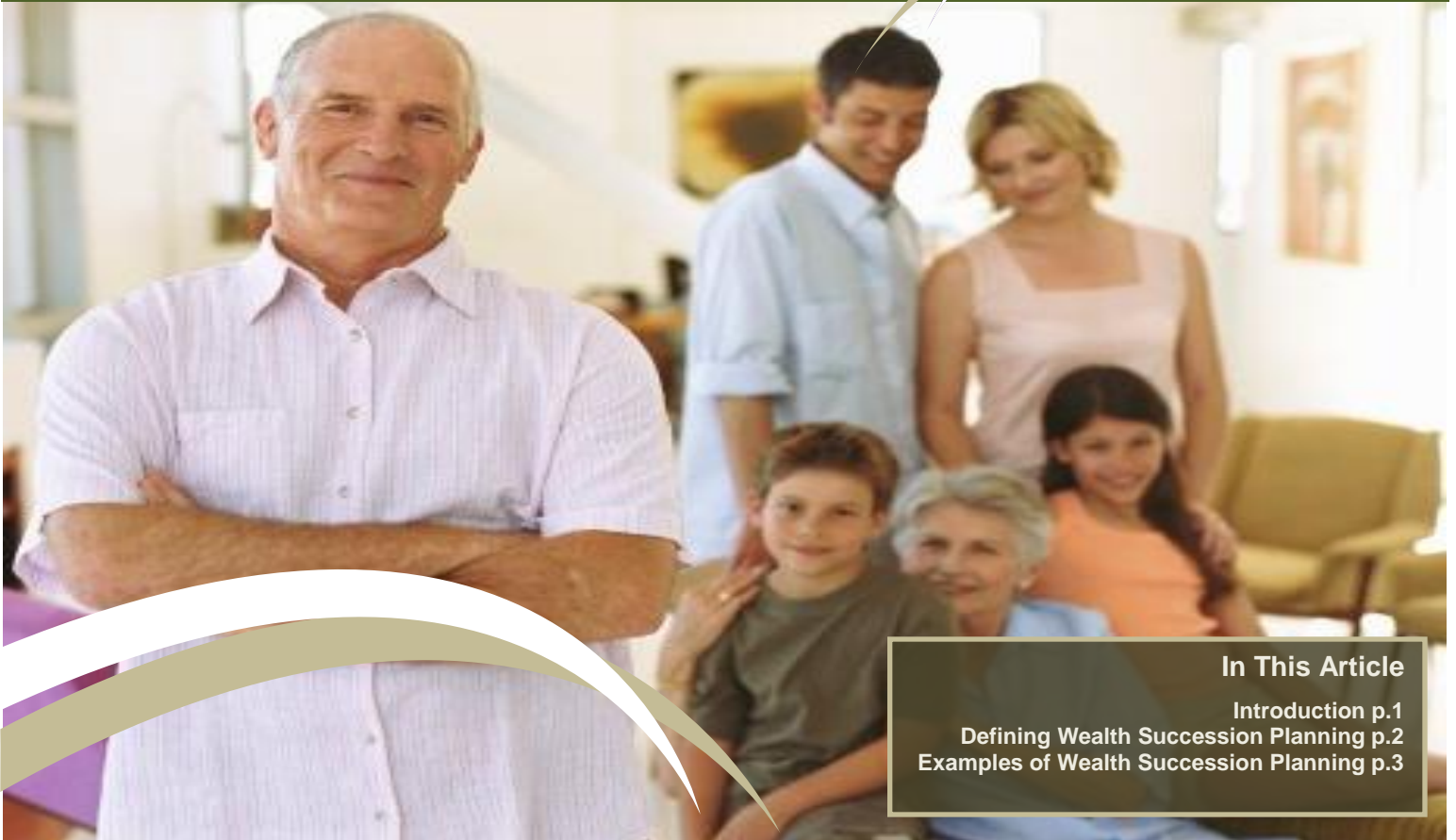


Wealth Succession Planning

Asset Backed Insurance Lending (ABIL)

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Introduction: Wealth Succession Planning

The more you're worth, the more valuable the following wealth succession topics are to your family's economic and tax well being. All are intertwined.

Unfortunately, most wealthy families fail to implement any viable plan because their advisors never proactively offer one. And even though most wealthy families and business owners think their situation is especially unusual or unique, we've found they're all asking most of the same questions:

- What is the best way to transfer my wealth - including my business - to my children, tax free?
- How can I protect my assets from creditors or litigators?
- Can I create protected, tax free wealth during my lifetime? At death?
- Why do the wealthy buy so much life insurance? Who should own the policy and be the beneficiary?
- Can I really give substantial gifts to charity without reducing my family's inheritance?

6 AREAS OF WEALTH SUCCESSION PLANNING

- Estate Planning
- Business Succession
- Wealth Transfer
- Asset Protection
- Life Insurance
- Tax Free Wealth Creation

Defining Wealth Succession Planning



Let's consider one of the more important topics within the Wealth Succession Planning universe – Life Insurance.

Why do the wealthy need life insurance?

Because the wealthy are so heavily taxed, they are always looking to make money or preserve assets in a tax free or tax advantaged environment. Unfortunately, the wealthy and most of their attorneys are not aware of or do not understand the tax free and other planning benefits of the insurance. We know this because our background is the Law and Financial Planning. We've traveled the country talking to clients and their advisors.

During Life – life insurance cash surrender values accumulate tax free. Policy loans can facilitate tax free cash flow. Loans are repaid by the death proceeds. We've even implemented a special cash flow design using asset backed insurance lending.

At Death – life insurance proceeds are tax free to their heirs. Commonly used strategies ensure the proceeds are also estate tax free.

Life insurance is the only product we know of that can provide lifetime tax free benefits and also deliver a large death benefit tax free to the heirs and estate.

Estate Planning is not the same as Wealth/Business Succession Planning. Most families think they need an estate plan to address what are really lifetime planning issues. Most estate plans focus on managing the testamentary estate as a whole, as well as tax avoidance. A family Wealth Transfer Plan focuses on specific assets that comprise a client's wealth, rather than the estate as a whole or the tax incurred because of the total value of the estate.

For example, if a client's assets total \$20 million and the potential estate taxes are \$8 million, the client really only has a net worth of \$12 million to pass to heirs. A Wealth Transfer Plan, instead of trying to lower the \$8 million in taxes, facilitates the transfer of the entire \$20 million to the heirs, with all taxes satisfied by some other means. The bottom line is that a Wealth Succession Plan is a lifetime planning opportunity, designed to be integrated with your family's plan for death, the Estate Plan.

A WEALTH SUCCESSION PROBLEM

| | |
|------------------------------|----------------------|
| Earn | \$20 million** |
| <u>Less Income Tax (40%)</u> | <u>\$8 million</u> |
| Balance | \$12 million |
| <u>Less Estate Tax (55%)</u> | <u>\$6.6 million</u> |
| Net to Family | \$5.4 million |

-OR-

| | |
|------------------------------|---------------------|
| Real Estate or Business | \$20 million |
| <u>Less Estate Tax (55%)</u> | <u>\$11 million</u> |
| Net to Family | \$9 million |

**If you pass a business/real estate worth \$20 million to family or partners, someone must account for the \$11 million tax bill due the IRS. Consider also that the business or real estate may have to be liquidated at "fire sale" prices, in order to pay the estate tax. The family or partnership is likely to lose the asset, with a remaining post-sale, post-estate tax lump sum substantially less than what is needed to live on for future generations.



Example #1: Wealth Creation for Wealth Succession

Mr. Smith is a healthy business owner. He is 54 years old. He has two children. He purchases a \$10 million Universal Indexed Life Insurance Policy. The annual premiums are \$145,000. The cash accumulation in the policy is tax free. At some point, Mr. Smith may decide to draw cash from the policy in the form of loans against the policy, thus supplementing his retirement income. The cash flow from the policy is tax free. The loans will be paid back from death proceeds. At death, the policy proceeds may be used to pay all the taxes due for the transfer of the family assets, business or real estate. The policy proceeds are tax free to the heirs and if properly structured, are estate tax free as well. Over Mr. Smith's lifetime, the cash build-up in an indexed product could be substantial, with no risk to principal. And the policy proceeds would cover the costs, expenses and taxes of the estate (\$6.6 - \$11 million), thus passing the primary family and business assets in their entirety.

Caveats: The most common planning tool for excluding life insurance policy death proceeds from your taxable estate is the Irrevocable Life Insurance Trust (ILIT). The ILIT must be the owner and beneficiary of the policy. Unfortunately, in order to fund the ILIT so it can pay the annual premiums, someone must gift the premiums to the ILIT. This incurs a gift tax after the \$1 million lifetime gifting exclusion is exhausted. So, in our example above, the annual premium could total \$190,000+ per year for life. If Mr. Smith lives 30 years, his total outlay for insurance would be \$5,700,000+. Paying for this insurance is expensive, but still substantially less than the ultimate face amount.

Alternative Example: Wealth Creation for Wealth Succession

Same facts as the preceding example, except that Mr. Smith chooses to finance the premiums (asset backed insurance lending). He would enjoy all the same benefits offered by life insurance, with additional advantages. By financing the premiums, Mr. Smith would not only avoid the annual gift tax (the ILIT is borrowing the premiums, so no gifts), he would not pay anything out of pocket. All costs and interest accrue. He would have to post some collateral for a period of time. His actual risk is his outside guarantee of the difference between the outstanding loan amount in relation to the cash build-up in the policy. Once the policy cash value surpasses the outstanding loan amount, Mr. Smith is no longer "at risk" as a guarantor. The policy stands as the sole source of collateral to the lender. Mr. Smith's peak at risk collateral amount would be \$868,000 in year 6, but then drops to zero by year 10. By year 6, if he had purchased the insurance, he would have paid \$1,140,000 by then anyway. Ultimately, Mr. Smith's estate or business will benefit from a \$10 million policy, while posting some collateral for a period of time, but with little or no money out of pocket.

As a basic starting point for Wealth Succession Planning, a wealthy family should consider leveraging their ability to secure life insurance. The product offers plentiful planning opportunities and almost all are tax advantaged. Families can implement a pay as you go strategy or consider the more advanced but cost effective world of asset backed insurance lending. At a minimum, families should ask their advisors to be proactive when it comes to planning for proper Wealth Succession.



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