



LPL Financial

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Life Insurance: Estate Planning





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What is life insurance?

A contract

Technically, life insurance is a contract between the policyowner (which can be you, "the insured," or a separate party) and an insurer. The policyowner agrees to make premium payments, and the insurer agrees to provide a specified sum to a designated third party (the beneficiary) upon your death.

Tip: Contracts, including life insurance contracts, are governed by state law.

And a will substitute

Because proceeds are paid directly to the beneficiary, life insurance can bypass the probate process, saving both expense and delay.

Purchased for four primary reasons

Life insurance is one of the biggest players in the estate planning game. For some, it is the only way to ensure that family members will be able to support themselves after the death of the primary wage earner. For those with larger estates, life insurance can provide the funds needed to pay estate taxes (and other costs) without liquidating estate assets. For those with a business interest, life insurance can be used as a vehicle for business succession. Finally, for those with a generous spirit, life insurance can permit you to make charitable gifts.

Advance planning needed to avoid taxes

Although life insurance proceeds are generally received by the beneficiaries income-tax free, they may be subject to estate taxes if you do not plan in advance.

Is it life insurance?

The following are considered life insurance proceeds under the Internal Revenue Code:

- Death benefits paid under regular life insurance contracts
- Death benefits paid under a workmen's compensation insurance contract
- Death benefits paid under an endowment policy where death occurs before the contract matures
- Death benefits paid under a group life policy
- Death benefits paid under a National Service or U.S. Government Life Insurance policy
- Death benefits paid under a double-indemnity provision
- Death benefits paid under an accident (or accident and health) policy
- Death benefits attributable to paid-up additions and term additions purchased with dividends paid on a policy

Why buy life insurance?

Provides an income for your family

Life insurance can provide your family with immediate cash to cover their day-to-day living expenses after your death. This may be desirable if your estate is small so there would be little left for your family to fall back on after payment of debts and expenses. This may also be desirable if: (1) your property has a high value but is not income-producing, (2) you have heavily invested in speculative securities, (3) you have parents, young or disabled children, or other family members who are dependent on you, or (4) your property is weighted heavily on the variable side.



Provides for the special needs of your family

Life insurance can provide funds for your children's (or grandchildren's) education, or it can be used to satisfy the special needs of individual family members (e.g., financial demands of a physically or mentally handicapped or learning disabled child, aging parents, or other dependents with physical or mental limitations).

Provides for children of a previous marriage

In today's world, a family is often a mixture of "yours, mine, and ours." If this is the case in your family, you may need to plan ahead to ensure that your assets are sufficient to provide for your new family as well as your children from a previous marriage . Life insurance may be one option that is right for you.

Provides cash for payment of estate expenses and debts

Life insurance can provide funds for payment of federal and state death taxes and other estate settlement costs.

Can be used to fill business needs

If you are a business owner, life insurance proceeds can be used to:

- Fund a buy-sell agreement
- Finance nonqualified deferred compensation arrangements
- Finance death benefit only (DBO) plans

Can be used to fund a charitable gift

Life insurance proceeds can be used to fund or supplement charitable donations . This can be accomplished in two ways: by having the proceeds paid directly to the charity or by using the proceeds to replace other assets given to charity.

What are the advantages?

Provides large amounts of cash at a relatively low cost

Life insurance can provide your family with a large amount of cash immediately upon your death. Usually, the proceeds exceed the amount you paid in policy premiums.

Is relatively risk-free

Investment in life insurance is fairly safe (i.e., life insurance companies rarely fail or become insolvent) as compared to other investment vehicles, and generally offers a higher return than traditional savings accounts.

Avoids income tax

In most cases, life insurance proceeds are not taxed as income to the beneficiary.

Caution: *There are a few exceptions, such as the transfer-for-value rule.*

Exempt from some state death taxes

Some states completely exempt life insurance proceeds from death taxes.

Avoids probate

Where the beneficiary is someone other than the insured's estate, life insurance proceeds are not included in the insured's probate estate, thereby avoiding the cost and delay of probate.

Ensures privacy

Because life insurance proceeds generally are not subject to probate, there is no public record of who receives the death benefit



or how much each beneficiary receives.

May be protected from creditors

In some states, life insurance policies or proceeds are not subject to claims of creditors of the owners or beneficiaries of the policies.

What are the tradeoffs?

May not be available to everyone

Life insurance may be difficult or impossible to obtain if you are in very poor health.

Shopping isn't easy

Life insurance is a complex product, to say the least. Gathering information about various life insurance products and understanding it is a difficult task. To make the right choices, you must do some comparison shopping. Seeking a professional's help is advisable.

Premium payments deplete your current funds

Of course, life insurance isn't free. You will have to make premium payments in one form or another. The money you spend on premiums is money not spent on something else. Money spent on premiums is, in most cases, money not included in the insured's estate (i.e., is not used to purchase assets which are included in the insured's estate) and may therefore lower the overall impact of estate taxes for some persons.

May be subject to estate tax

Generally, life insurance death proceeds are includable in the insured's gross estate subject to estate taxes unless an exception applies.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

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