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LIFE INSURANCE: DON'T LEAVE EARTH WITHOUT IT—PART II

Twenty-two years ago, as a neophyte life insurance agent, I helped form a sales networking club. A fellow net-worker, Doug, would supply me with leads by telling others, "If you want to die broke, don't talk to Phil Henry!" Another friend, Mike, would add, "You don't need to like life insurance. You just need to have it!" Now that I am a full-service financial planner, their sentiments remain in my thinking.

In my previous article, I discussed the first of three important questions: How much life insurance do you need? I mentioned a hypothetical client, Sam, who earned \$150,000 per year and needed \$2,000,000 in life insurance, an amount roughly 13 times his income, to properly protect his family. His wife and homemaker, Sally, needed \$500,000.

The second question about life insurance is: What kind should I buy? Term and Permanent are the two basic kinds of life insurance. Term life provides coverage for a temporary period. Level Term is the most popular type today and features affordable, level premiums for a given period, usually 10, 20, or 30 years. Of all term policies sold, however, only 1 percent ever results in payment of a death claim. The reason: After the level period expires, renewal premiums become prohibitively expensive. Please understand that I recommend large term policies over smaller, permanent ones when cost is an issue. Beneficiaries never ask me what kind of insurance their loved ones or business partners had, but rather how much life insurance they had.

Permanent Insurance is designed to last for one's life. Premiums are much higher initially, but usually cost less over one's life expectancy. Permanent insurance may also build equity, referred to as "cash value," from which the owner can take low-cost loans. Popular types of permanent life include Whole, Universal, Variable (investment-oriented) and Survivorship Life. This last one pays a benefit at the death of the second of two insureds, and is usually purchased to cover estate taxes.

Many policies sold in the past were purchased on the premise that if a certain interest rate or investment return were maintained, the policy could be paid-up at a future point or would involve reduced annual premiums from the inception. Because many of these projections were not met, these policies now need additional funding to be maintained. A newer version of permanent insurance has addressed this concern. Referred to as a "No-Lapse Policy," this form of coverage guarantees that if a pre-determined premium is maintained, the policy will never lapse.

The third important question related to the purchase of life insurance is this: How should one structure a policy's ownership and beneficiary designations?

Death proceeds from most life insurance policies are free from income taxation, but the

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proceeds from the life insurance one owns becomes part of one's estate. The gross value of one's estate is calculated at death. For example, for deaths occurring in 2005, a person may have a gross estate of \$1,500,000, including life insurance, and not have estate taxes imposed. But if a person owns a \$2,000,000 life insurance policy and dies in 2005, that value alone puts the estate on the estate tax radar.

To avoid this, one can arrange for an Irrevocable Life Insurance Trust (ILIT) to be the owner of the policy. A qualified estate planning attorney can establish an ILIT as part of a family's overall estate planning goals. If an ILIT is created, purchases the policy, and pays the premiums, the same \$2,000,000 death benefit would not be included for estate tax purposes in the insured's estate.

The ILIT also serves as the beneficiary of the policy. Proceeds from the insurance policy flow into the ILIT, and are then paid out by the trustee according to a predetermined plan. This plan can flexibly accommodate changing future needs.

I'll move on to another topic in the next issue. For now, knowing enough to have life insurance and what type of insurance to buy may help increase your understanding of this subject.

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