LET'S TALK MONEY®

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Life Insurance and Taxes

Life insurance is a crucial element to most personal risk management strategies, but it can also be one of the most tax-efficient vehicles in your financial toolkit. The following examines how life insurance may affect your overall tax picture.

It's About Life

Life insurance is sometimes called the gift of love. In its most basic form, you buy a life insurance policy for its lump-sum death benefits directed to your beneficiaries. For most people this benefit is a way to financially protect loved ones, but there may be tax consequences, too.

There are no tax benefits connected to premiums you pay for an individual life insurance policy, but you may owe income tax on employer-paid life insurance of more than $50,000 or if your premiums were tax-deductible. Beneficiaries may also owe income tax on employer-paid life insurance if any cash value increased the death benefit.

However, death benefits are typically income-tax-free to the beneficiary in most instances, and cash value (in those policies that offer it) grows tax-deferred. Dividends, which some life insurance policies pay when expenses are lower than anticipated, also don't trigger taxes. Dividends are not guaranteed. There are a number of ways that cash value and insurance surrendered during your lifetime can have tax consequences, so work with your financial and tax professionals to make sure you don't trip over certain rules.

Ownership Matters

Most families that pay life insurance premiums with after-tax money either through the workplace or individually won't notice any tax advantages until the policy's death benefits are paid. That's when beneficiaries receive benefits that are typically income-tax-free. This isn't necessarily the case, though, when it comes to estate taxes.

True, the federal estate tax exemption amount has increased markedly to over $11 million (over $22 million for couples filing jointly) in recent years, affecting only a small percentage of Americans. But some states that levy estate and inheritance taxes have much lower tax thresholds.

If you use a life insurance trust to buy and own life insurance (with the help of an estate planning attorney), you can help shield loved ones from estate taxes on the death benefit, no matter how much it is.

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Insurance Version

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How to Conduct a Campus Visit

You and your college-bound child have agreed on a list of schools to visit. Now, how do you make the most of your summer whirlwind of visits?

Explore the College Town

Some universities may be cities unto themselves, but most are often an integral part of their region. Are the school and the surrounding area safe? Does the city offer public transportation and cultural options?

Attend in Session

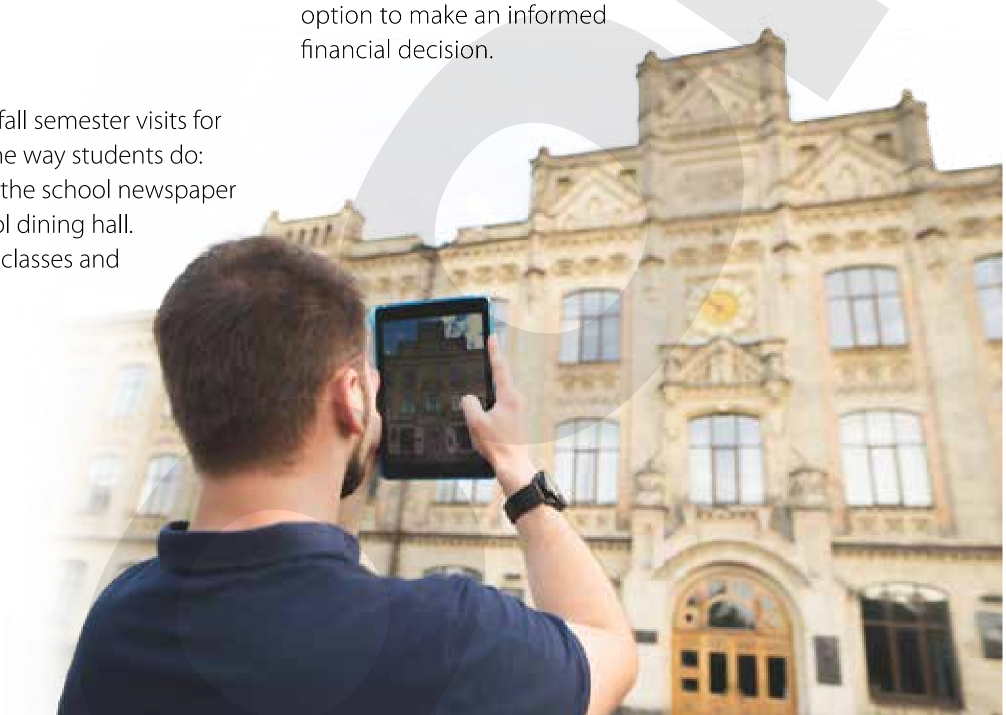
Try to schedule some late spring or early fall semester visits for your child to experience the institution the way students do: talking to current students, checking out the school newspaper and radio station, and eating at the school dining hall. They can plan to go to the library, attend classes and schedule visits with department chairs in their area of interest to learn more.

After Class

Because college is a comprehensive experience, your child will want to check out the gym, living arrangements and social opportunities. Schedule a campus tour to learn more and don't be afraid to ask questions. Check out the student center, where many students study and spend free time.

Take Your Time

Long delays in your decision-making could cost you financial aid, but you don't want to make rash decisions, either. You and your student should consider the costs and benefits of each option to make an informed financial decision.



Plan Ahead for Summertime College Visits

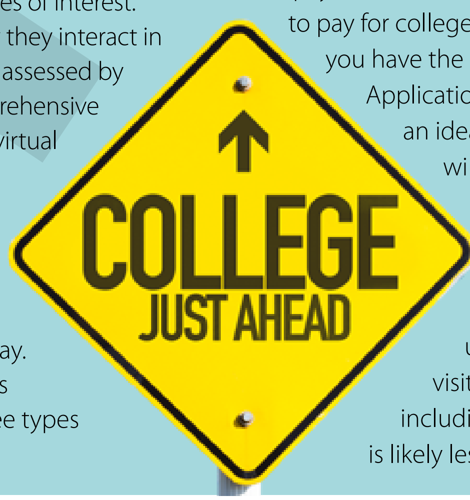
If you ever had a child entering senior year of high school, you know the drill: Time to make the rounds to different colleges your child is interested in. But before you begin your trek, make sure you take the time to come up with a list of schools that fit your wallet and your child's interests.

Plan Early

Read everything you can about the colleges of interest. Follow them on social media to learn how they interact in today's connected world and how they're assessed by current students and alumni. Take a comprehensive look at each college's website, and take a virtual tour if the website features one.

Crunch the Numbers

Don't even waste your time visiting a college or university if the costs, after financial aid, are more than you plan to pay. Also remember that parents and students typically have to pay back two of the three types of financial aid.



Financial aid may be a package of loans, which will require repayment, and work study, in which case the student works to pay for college. You don't, however, pay back grants. Once you have the numbers and a completed FAFSA (Free Application for Federal Student Aid) form, you can get an idea of how much your top-rated schools' aid will reduce your current and future costs.

Keep it Manageable

Get serious about planning to visit three to five top-choice colleges and universities, plus keep your schedule open to visit one or two fallback institutions — including your home state's school, where tuition is likely less expensive.

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When You Need More Than a Will

While you can create a will yourself through an online legal service (see accompanying infographic), consulting with your legal, tax and financial professionals may help you uncover financial challenges that a will alone cannot address. A trust may help you meet these challenges. Whether you have a modest estate you wish to shield from the public glare of probate or you want to reduce estate and inheritance taxes on a large estate, there is a trust to meet almost any estate planning challenge.

Two Types of Trusts

While there are many trusts, they all fall into two categories: revocable and irrevocable. They are what their names imply: You can amend and terminate a revocable trust, two things that are extremely difficult to do with an irrevocable trust. A revocable trust is designed for control and to keep financial affairs out of probate, not to reduce estate taxes.

Life Insurance Trust

One common type of irrevocable trust is a life insurance trust. While life insurance death benefits are usually income tax-free, they are subject to estate taxes. The threshold at which federal estate income taxes begin is more than most estates' value, but state inheritance taxes could kick in at much lower levels in some locations.

A life insurance trust, not the estate, is the owner and beneficiary of the life insurance, and distributes its death benefit to beneficiaries named in the trust tax-free after the insured person dies.

How Much Life Insurance Do You Need?

If you have loved ones, you likely understand the importance of life insurance. Choosing the appropriate type of life insurance for your situation is important but choosing the appropriate amount may be the most crucial decision you make.

Rules of Thumb

There are generally two ways financial consumers figure their potential life insurance needs. One way is to simply multiply estimated annual income by a factor, usually between six- and 12-times income. These formulas are not exact but offer an easy way to calculate income replacement.

Customize It

A more exact way to figure out your needs is to use projections. Take your annual income and subtract income that would replace it, such as a spouse working and Social Security benefits. Subtract this added income from your current income to find the annual deficit. Or figure your expenses, especially large ones including a mortgage, childcare and college costs, and then subtract your replacement income from them for your annual net expense.

Multiply the projected annual income deficit or the annual net expense by the number of years you need to make up the shortfall, and you'll have a better idea how much you need.

Five Reasons You Need a Will

Having an up-to-date will is one of the most important planning steps you can take in any area of your life. If you don't believe this, consider these reasons why you might change your mind. Through a will, you can:

1. Name legal guardians for your minor children

2. Direct who will receive your assets after you pass

3. Designate your executor, who will help distribute assets and settle your estate

4. Help prevent misunderstandings

5. Donate to charity

The Gift That Keeps on Giving

While it pales in comparison to the excitement of giving and receiving smartphones and tablets as gifts, the gift of life insurance can have a much greater impact over time. From gifting an in-force policy to making annual gifts meant to pay premiums, you can have a lasting impact on the financial fortunes of loved ones through life insurance.

Gifting Premiums

Giving annual cash gifts to as many people as you want is a great way to reduce your taxable estate, and by itself it can also provide a means to provide future wealth, especially if those receiving the gifts put it toward insurance on your life that names them as beneficiaries. Note here that you can't force the gift recipients to buy life insurance. With proper structuring and the help of qualified financial and tax professionals, your gift can help you leave loved ones a financial legacy after you're gone.

Irrevocable Trusts

Another way to leave estate-tax-free life insurance to loved ones is to establish an irrevocable life insurance trust, with terms saying your gifts to the trust are for life insurance premiums on your life and for the benefit of your beneficiaries. There will be a cost to establishing this trust, as well as a loss of control outside the trust's written terms, but this gifting method can help you leave more behind.

Existing Policies

One more way you might consider leaving life insurance to loved ones is to gift an existing policy, either directly to loved ones or to an irrevocable trust for the benefit of the trust's beneficiaries.

This transfer comes full of potential tax pitfalls, which makes working with dedicated professionals essential. For example, transferring a policy whose current value exceeds the annual gift tax limit could trigger taxes. Transferring a policy that has had a loan taken against it can also cause tax complications. Also, beneficiaries may not receive the full tax benefits of the gift of life insurance — or any asset, for that matter — if the transfer occurs less than three years from the donor's death. Talk to your insurance and tax professionals who can help you to avoid complicated surprises.

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