

Second-to-die insurance still makes sense



By Faith Read Xenos, CFP

Second die life insurance insures the lives of two people rather than one. It can provide much needed protection for families facing a large estate tax bill on the death of the surviving spouse.

Changes in estate tax laws under the Taxpayer Relief Act of 1997 address the devastating effect that estate taxes have on business owners who are asset rich but cash poor. However, the changes do not go far enough, and if you own a family business, it may still need to be sold or your heirs may be forced to take on burdensome debt to pay estate taxes.

Included in the estate tax changes is a gradual increase in the estate and gift tax applicable exclusion amount from \$600,000 in 1997 to \$1 million in 2006. However, the actual tax savings attributable to the increase in the applicable exclusion amount may be reduced by inflation to a negligible amount.

Advantages of Second-To-Die Policies

Second die life insurance is an option to consider if you need liquidity or you want to replace family wealth used to pay taxes. By insuring two lives, typically the lives of you and your spouse, this type of life insurance can provide the necessary cash when estate taxes are due.

Although a single life policy can also fulfill this objective, a second die policy generally has the advantage of lower premiums. Because the insurance company's risk of paying the policy earlier than expected is lower when the risk is spread over two lives, a lower premium can be charged presumably. In addition, the insur-

ance company has a longer period of time to collect the premiums. Another advantage is that the insurance company may be willing to provide insurance coverage for two lives even if either you or your spouse is otherwise difficult to insure or uninsurable.

Insurance Trusts

When purchasing a second die policy, consider using an irrevocable life insurance trust to hold the policy. You can use the trust to remove the proceeds of the policy from the estates of you and your spouse. No estate tax is due on the policy proceeds if properly arranged. The cost of obtaining this benefit is that the insurance trust must be the owner of the policy, and both you and your spouse must surrender your rights to the policy so that neither of you is deemed to be the owner. You can accomplish this through either you or your spouse making annual exclusion gifts of the amount of the premium to the insurance trust. The beneficiaries of the trust, usually your children, have a limited time to withdraw the gifts. If they don't, then the money is used to pay the life insurance premiums.

On the death of the surviving spouse, the insurance trust receives the policy proceeds. It can then provide liquidity to the survivor's estate by making loans to the estate or by purchasing assets from the estate (with no resulting capital gain due to the step up in basis received by the estate). The terms of the insurance trust will likely mirror your estate plan as a whole, and distributions can be made to beneficiaries accordingly.

Paying the Premiums

One issue to address when purchasing second die life insurance is how the premiums will be paid on the death of the first spouse. If he or she generated income that was used to pay the premiums, then another source to pay those premiums must be found after the death of that spouse. Identify other income or

assets that are available to pay the premiums. Otherwise you may use either an insurance policy on a single life or add a rider to the second die that will pay up the policy or provide substantial funds to pay future premiums. Consider the amount of the annual premiums, because after the first death, the annual exclusion gifts may no longer be split between you and your spouse. For example, if you and your spouse were splitting gifts and making \$20,000 gifts to the insurance trust for each of your children, then after the death of you or your spouse, only \$10,000 of annual exclusion gift can be made per child.

Low Cost Liquidity

The recent changes in the tax laws that provided some relief to business owners aren't sufficient for those who are asset rich but cash poor. Second die life insurance can still be an integral part of an estate plan providing liquidity to meet estate tax burdens at a low cost. Please call us to discuss the advantages of a second die policy for your estate plan.

For more information write to Faith Read Xenos, CFP Principal, Singer Xenos Investment Management, 800 Douglas Road, Suite 148, Coral Gables, FL 33134 or call 305-443-0060.