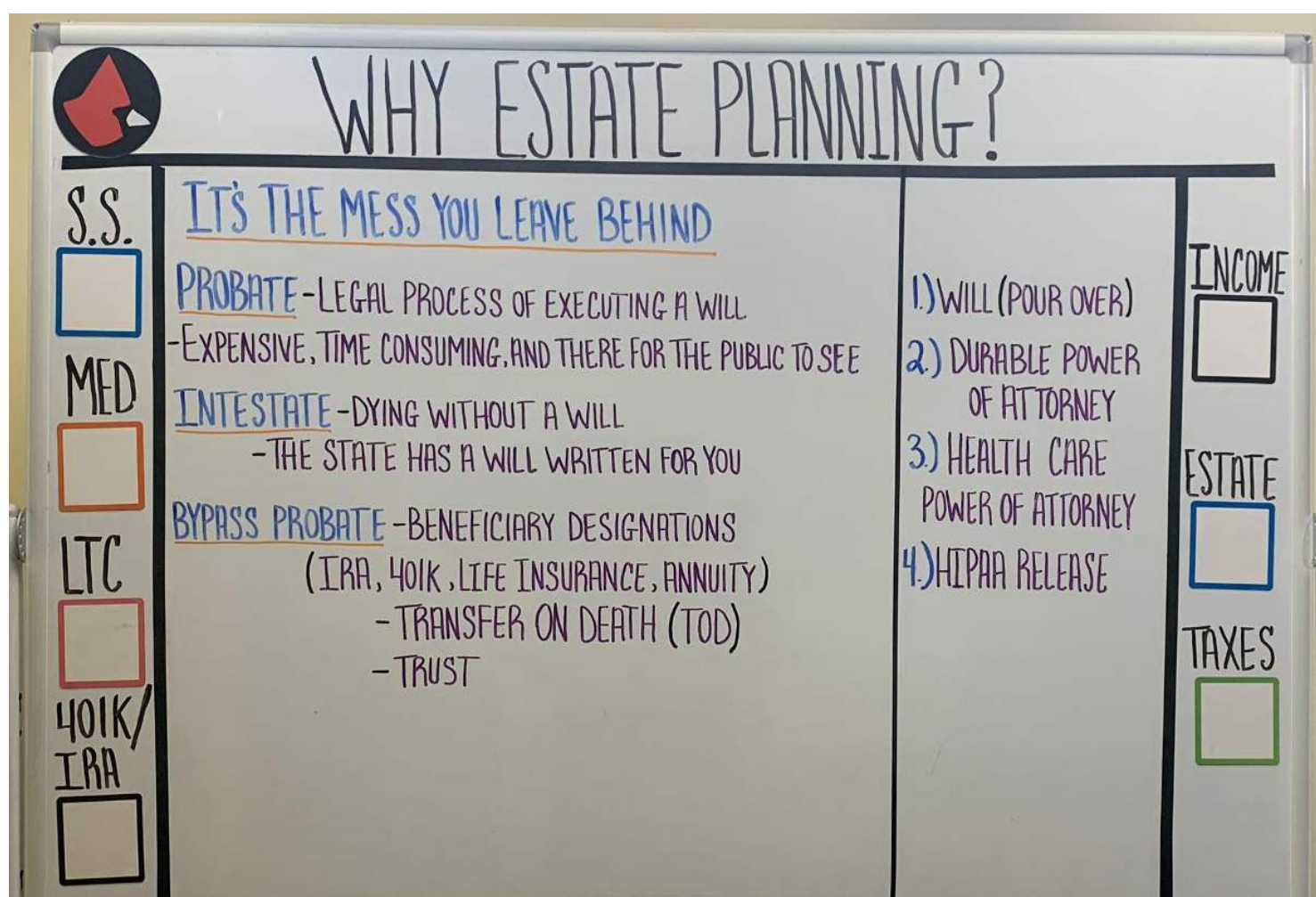


CARDINAL ADVISORS

Why Estate Planning?

In our video entitled "Why Estate Planning? Hans and Tom use Chapter 7 of the Complete Cardinal Guide to discuss estate planning.



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April 2024

THE COMPLETE CARDINAL GUIDE

TO PLANNING FOR AND LIVING IN RETIREMENT



Navigating Social Security,
Medicare and Supplemental Insurance,
Long Term Care, IRA,
Life Insurance,
Post-Retirement investment
and Income Taxes



Hans Scheil

LIFE INSURANCE, ESTATE PLANNING, AND YOUR LEGACY

This chapter focuses on life insurance. The stories I'll share about the experiences of a few of my clients will demonstrate how life insurance relates to other assets like IRAs and fits into the overall picture of strategic and effective estate planning. They will also highlight some of the complications to watch out for and problems that can be avoided with good planning.

Maybe the name Kenneth Feinberg is familiar to you. He was appointed by President Bush to determine compensation for victims of the September 11 terrorist attacks and their families, and later by President Obama to do the same for the families harmed by the BP Deepwater Horizon oil well blowout in the Gulf of Mexico. Feinberg wrote a column for the *New York Times* explaining how working with the September 11 families changed his own outlook on estate planning. It is worth quoting at length, because what he learned highlights both the importance of good planning and the shocking lack of such planning among so many Americans.

In the last 30 years, presidents, governors, mayors and others have delegated to me the unenviable task of putting a value to the lives of people who are already dead....

In taking on these tasks, I have come to realize that, whatever your personal wealth, money is a poor substitute for loss. It neither tempers the grief accompanying traumatic death or physical injury nor fills the void left after tragic loss of life. During my administration of the September 11th Victim Compensation Fund, I recall one mother responding to the \$3 million she would receive for the death of her son. "I have a better idea," she said. "Keep the money and bring my son back."

I have also become much more fatalistic, which has influenced my own personal financial planning. In effect, I've received on-the-job training for managing my own wealth and protecting it for my wife and family. After the 2001 attacks, I sought the advice of a financial planner having witnessed firsthand what can happen when people don't have expert financial advice.

The 9/11 fund offered free financial advice to all claimants receiving compensation. Goldman Sachs, JPMorgan Chase and others stood ready to help, but only 78 of 5,300 eligible claimants took advantage of the opportunity. "We don't need any expert advice," was the overwhelming response.

After meeting with the planner, I updated my will, something I had been putting off. Over half the victims on Sept. 11 did not have one. Given that they were relatively young and in good health with excellent jobs, they seem not to have thought it was necessary. I suddenly found it necessary. I also selected a law firm specializing in trusts and estates that knows exactly how I want my wealth distributed after my death.

It was also important to me to avoid the problems I occasionally confronted after Sept. 11, when angry siblings, parents and relatives declared war with one another over the victim's assets and argued over the 9/11 fund compensation. When millions of dollars are suddenly available for distribution, family members, fiancés and same-sex partners sometimes engage in bitter arguments. So I made sure that my wife and three children had a clear understanding of who gets what by providing each of them a detailed memorandum listing all of my assets and an explanation of how my wealth should be distributed after my death.

I also bought substantial additional life insurance. I bought a mix of term and whole life insurance, because I wanted short-term protection in the event of my untimely death and a long-term investment vehicle. I was astounded to learn that *over half the victims of the Sept. 11 attacks had no life insurance* (emphasis added). Were it not for the 9/11 fund, such a grievous oversight would have placed many victims' families at financial risk.

When it came to my investments, long-term safety and gradual growth suddenly seemed far more important than any short-term profits and quick gains. I wanted to be assured that the bulk of my wealth would be available for my wife, children and grandchildren.

Finally, in managing my individual portfolio, I have become a firm believer in the "cushion" theory of investment. I have saved more of my annual income than many people would consider to be necessary. Hundreds of Sept. 11 victims failed to set aside sufficient funds to provide for their families, believing that future earnings would be available to make up for any current shortfall. But the terrorist attacks interrupted such plans. Saving today is a hedge against unknown events tomorrow.

Nobody is immune from life's misfortunes. It need not be a terrorist attack or the acts of the gunmen at Virginia Tech; Newtown, Conn.; or Aurora, Colo. We all face uncertainty and risk. All the more reason to pause today and carefully plan for tomorrow.

— Kenneth Feinberg, "Money Admonitions from 9/11,"
New York Times, March 25, 2015

I personally had a similar experience. My sister Margot passed away suddenly from a brain aneurysm one morning in January 2011. I never got the chance to say goodbye and I miss her very much. She was an RN and a Nurse Practitioner and worked three jobs. Her husband Bill is a CPA. Despite having a father who was a 32-year insurance agent, and a brother in the life insurance business all her life, Margot passed with no life insurance. Bill told me at the funeral, “two incomes are great, one income sucks.” I think about Margot and Bill every time a client procrastinates about buying life insurance. Margot was pretty hard headed and it was difficult to sell anything to her. If I could do it all over, I would let go of my excuses, dig in my heels, and sell both of them a policy. This is clearly a story of the plumber with leaky pipes in his own home.

Benjamin approached me while I was conducting a financial planning seminar at his church. He is 77 years old, and has type II diabetes and a pacemaker. Two years ago, Benjamin built a new home on one level so that he and his wife Daphne can live out the rest of their years there. Benjamin has two military pensions, but they have no survivor benefits. If he goes first, Daphne will have a hard time making the payments on the home. Benjamin told me he saves \$2,000 per month (from his pensions and Social Security) so Daphne will have some money for house payments if he dies first. He had

SUMMARY: STRATEGIZING LIFE INSURANCE AND ESTATE PLANNING

- Calculate the amount of money your survivors need to receive quickly after you pass away. Consider purchasing life insurance. If you don’t want to pay ongoing premiums, consider single-premium whole life insurance.
- Update all of your beneficiary designations. Beneficiary designations trump the will and go straight to the beneficiary.
- You need at least four legal documents prepared by an attorney knowledgeable about elder law: a will, a health-care power of attorney, a financial power of attorney, and a HIPAA release.
- \$\$\$\$\$ Federal estate taxes are no longer relevant for estates under \$5.43 million, or \$10.86 million for couples. The step up in basis at death for capital gains taxes is the more relevant issue for middle-class taxpayers.

accumulated \$25,000 and wanted my advice about investing this money. I suggested he look into life insurance and his response was that no one would write him a policy at his age and with his health conditions. But we were able to find one. We applied for a \$100,000 policy with guaranteed premiums to age 100. The premium is \$9,200 per year for five years and then decreases to \$7,200 in the sixth year and remains there until age 100. Voilà—Benjamin no longer worries about Daphne’s future if he should die first.

Benjamin then sent me to his aunt, who is the same age as he is. She has no savings and lives in low-income housing. I wrote her a \$5,000 permanent life insurance policy for only \$41 per month. She now feels relieved that the family won’t need to pass the hat at her funeral. Even a small amount of life insurance can bring peace of mind.

Nicole, discussed in chapter 4, is another client who bought a single-premium life insurance policy. In her case, she used \$300,000 she received from her mother’s trust to buy a whole life policy. The death benefit is \$540,000 initially and will grow as the cash value increases inside of her policy. Thus, her son Thomas is guaranteed to receive at least \$540,000 tax free when Nicole passes. Most people don’t purchase this kind of high-cost single-premium policy. In fact, they can be purchased for as little as one \$5,000 premium that will buy almost \$10,000 of life insurance, paid up for life. The health questions on these policies are very lenient because the insurance company gets your money up front. Also, a funeral home will generally accept the money from these policies as payment for a funeral. I find that insurance companies are usually better caretakers of your money than funeral homes.

Marshall and Elizabeth, other clients we’ve talked about previously, bought second-to-die life insurance worth \$300,000 when he was 80 and she was 76. The annual premium is about \$10,000 for twenty years. As I told you earlier, Marshall passed away from a heart attack just six weeks after the policy was issued. Marshall was really into planning for Elizabeth and their three sons; it was almost like he knew something was coming. The \$10,000 premium is paid from the minimum distributions from Marshall’s IRA. Those minimum distributions are guaranteed to last the rest of Elizabeth’s life through the annuity we set up for them (see page 41). Elizabeth is now 79 and she has peace of mind knowing that each of her sons will receive a tax-free check for \$100,000 very quickly after she dies, while time passes as her estate is settled. **Permanent life insurance does not cost as much as it used to, if you buy the right kind. I have delivered life insurance checks to hundreds of beneficiaries during my career and not once have I been asked any questions about the policy.** People are simply happy to receive some money from a deceased relative who loved them.

Four weeks before Marshall passed away, we had a meeting with his attorney. Marshall wanted me to advise the attorney directly about the documents I felt he and Elizabeth needed to put in place. **They each needed a will, a financial power of attorney (see appendix F), a health-care power of attorney, and a HIPAA release form (HIPAA**

is the Health Insurance Portability and Accountability Act, and it protects the privacy of individually identifiable health information; see appendix G). Most of this work had been done previously, but he thought it needed updating. It didn't, because Marshall had planned well. However, Elizabeth did need to update these documents after Marshall died, and her sons will need the documents if she becomes incapacitated and can't make decisions for herself. I am continually shocked by the number of clients we see at Cardinal who haven't taken care of preparing these inexpensive and critical documents. Unless you have a large and complicated estate, you really don't need a world-class attorney for simple documents, and the service should only cost about \$500 to \$600.

Jason and Megan's story, involving a complicated long-term care scenario, was described earlier (see page 19). Jason has a cash-value life insurance policy with a death benefit of \$100,000 that he purchased many years ago. Interest rates were 7%–8% when he bought the policy, but they have dropped below 2%, which means that his premium payments are not keeping up. The insurance company had been warning Jason and Megan about the impending lapse resulting from this decrease for years, but they never understood it. (A "lapse" in an insurance policy means the benefits are not available because the premium payments have not been made in time.) We read all the letters, contacted the insurance company with Jason on the line, and worked out a way to increase his monthly premiums and keep his insurance in force until age 90. Megan is going to need that \$100,000 to live on after Jason passes on. We encounter many clients with cash-value life insurance policies that are destined to lapse if some change is not made. To avoid a problem like this, get a professional to review all of your existing life insurance policies and ask him or her to request a proposal/projection from the insurance company based upon current assumptions. In addition, be sure to check the beneficiary designation, as well as the contingent beneficiary.

The Beneficiary Designation

In chapter 6 we emphasized the importance of making sure you have designated beneficiaries of various assets correctly to reflect your wishes. As noted, these designations determine what happens regardless of what a will, a divorce decree, or other legal documents may say. This can be of particular urgency for life insurance policies, which may have been purchased years ago before your family circumstances changed. **I repeat: The beneficiary designation in most instances trumps the will and probate decisions.** Most clients don't know this simple fact. If you own life insurance, annuities, IRAs, or anything with a beneficiary designation, the money will pass directly to your named beneficiary, never passing through the lawyers or the will. **Make sure your beneficiary forms are up to date!** We find clients coming in the door with ex-spouses, deceased relatives, and estranged family members named as

beneficiaries, their policies not having been updated for years. You don't want to make that mistake.

A recent court case underscores the risk of inattention to these details. In *Herring v. Campbell* (No. 11-40953, decided August 7, 2012), John Wayne Hunter, a retiree of Marathon Oil who participated in the company's pension plan, died without designating a beneficiary for his plan proceeds after the death of his wife the year before. His two stepsons, whom he had helped raise with his wife but never legally adopted, filed suit after Hunter's death to challenge the distribution of his retirement benefits. The company plan administrator had rejected the possibility that the stepsons might be defined as Hunter's "children" and therefore entitled to his benefits. But they cited their close relationship with Hunter, the fact that Hunter left his estate to them, and the fact that he had referred to them as his "beloved sons" in his will. However, both a lower court and the U.S. Court of Appeals agreed that, because the company's retirement plan gives the administrator discretionary authority to determine eligibility for benefits, the fact that no beneficiaries were designated negated the language in the will.

"I love you wills" work great for married couples who both have been married only one time and only have children together. In such a case, the chain of inheritance is clear: "I leave everything to my wife/husband and if he/she predeceases me, everything goes to my children equally." If either of you has been married before and has children from a prior marriage, estate planning gets more complicated. For example, the union between Joe and Anita is the second marriage for each of them. Both have children from their previous marriages. When I asked them which kids get which assets, they assured me that the distribution was all taken care of in their will. Most of their assets are in IRAs that name each other as beneficiaries, and their real estate and business are held jointly. When one dies first, the other gets everything. But when the second one dies, which kids get what? Remember, what the will says doesn't count compared with the specific beneficiary designations of the IRAs, life insurance policies, and other assets with beneficiaries. **Married couples who leave it all to each other need to consider the ultimate beneficiaries after the second one dies, especially when they are in a second marriage.**

Changes in the Estate Tax

***** Wealthier citizens have recently benefited from changes to estate tax law. According to the *Wall Street Journal*, **"The federal estate tax is no longer the biggest concern for most affluent people who want to avoid taxes on wealth they leave to heirs.** For much of the past decade, it was. In 2004, for example, the estates of people who died owning assets worth more than \$1.5 million—or who made gifts above that limit while alive—were subject to federal tax at top rates approaching 50%, and mar-

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ried couples had to set up trusts to benefit from their full \$3 million estate exemption. In addition, there was extreme uncertainty as the tax bounced around from year to year and even disappeared entirely in 2010—making effective planning exceedingly difficult. Finally, in 2013, **Congress set the top estate-and-gift-tax rate at 40% and raised the exemption to \$5 million per person, adjusted for inflation. [In 2016 the exemption stands at \$5.45 million per person.]** Lawmakers also changed the rules so that couples don't need trusts to get their full break from Uncle Sam.... These changes have freed hundreds of thousands of affluent Americans from worrying about federal estate tax, and they may never have to.... Now many people who won't owe estate tax can reap substantial tax savings on capital gains by choosing carefully which assets to hold until death. This strategy is especially useful now that the top federal rate on long-term gains is nearly 24%, two-thirds higher than in 2012" (*Wall Street Journal*, "The New Rules of Estate Planning," October 24, 2014).

I wouldn't be surprised if you were not aware of this significant change. This again underscores the importance of working with an experienced, well-informed professional to evaluate your various assets and help you strategize all of your estate planning. In addition to the legacy of your character, the financial legacy you leave to your children and grandchildren is profoundly important to both you and them.