



Level**L4**Life

# Insurance Roadmap

Prepared for: **Valued Client**

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Prepared on: **01/01/2010**

## Where have they been?

Carrier's Name/Policy Number \_\_\_\_\_

- A. Was the insurance obtained for  Personal  Business Purposes
- B. What was the original purpose of the insurance (Circle applicable choices below)?

*It is important to determine what purpose the coverage was originally intended to serve, and whether that purpose is still valid. Whether it was intended to provide for business or personal needs, circumstances change. Coverage that was perfectly appropriate for one purpose may be inappropriate or poorly positioned to solve current problems.*

- Income replacement
- Estate liquidity
- Estate equalization
- Accumulation
- Special needs child
- Charitable legacy
- Key person
- Buy-sell
- Deferred Compensation
- Employee Benefit
- Debt retirement
- Family capital needs

- C. Is the original purpose still valid?  Yes  No

*Insurance that was purchased to provide income replacement when the insured was the father of a young family may not be needed for that purpose years later when the estate tax issues loom larger. Similarly, coverage that was put in place to solve estate tax problems may become outdated when the client's net worth declines dramatically as a result of business failure or investment losses, or if federal estate tax liabilities are drastically reduced.*

D. Amount of Coverage

*Sometimes coverage amounts are determined by “rules of thumb” which bear little resemblance to actual needs. For example, even though a business may be worth \$1 million, the stockholders may have decided to try to keep the value low for estate tax purposes. Or the business was valued \$1million when the insurance was put in force, but is now valued at \$5 million.*

*During the high interest era of the 1980’s on popular view was that an individual should purchase six times annual salary. The thought was that proceeds could earn 10%, a conservative interest rate assumption at the time, thus producing an income equal to 60% of the insured’s salary. Changes in the economy and the interest rate environment have drastically altered the mathematics of this approach.*

1. How was the amount of coverage determined?

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2. Is this currently an appropriate amount?

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E. How was it determined that this was the appropriate amount (ie. UL, WL, Term, etc.) of policy?

*Often the type of policy that is purchased is a function of temporary circumstances; sometimes it is purchased for the “wrong” reasons. For example, the client’s limited budget may lead to a purchase of term insurance, or marginally-funded UL contract. Issues surrounding the suitability of the coverage in relation to existing circumstances are appropriately topics for discussion.*

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F. The beneficiary of this policy is \_\_\_\_\_. Is this still appropriate in light of the current situation?

*Check to see whether the spouse that was named as beneficiary when the policy was issued is still the client's spouse; whether the estranged, substance-abusing adult child is still entitled to an equal, outright share of the death proceeds along with his/her model citizen siblings; whether the child that was born two years after the policy was issued is captured by the beneficiary designation. The issue is to make certain that the beneficiary designations match the client's current wishes, and that they are designed to accommodate a variety of changed circumstances in the future.*

- Divorce
- Remarriage
- Birth or adoption
- Change in attitude
- Change in life circumstances

G. Explore for tax traps

*Does the client want to make sure the proceeds of the policy are excluded from both the insured's estate and the estate of his/her spouse? If so, make certain the client has retained no "incidents of ownership" that would cause the proceeds to be exposed to estate tax.*

*The infamous "Goodman triangle" – where the owner, insured, and beneficiary are different parties – may result in the owner being treated as making taxable gift of the death proceeds to the beneficiaries at the death of the insured. (Example: Mom owns the policy on Dad's life, naming the Daughter as beneficiary).*

*Sometimes the client's corporation owns a contract on his life, naming his wife as beneficiary. Upon the insured's death, the corporation may be treated as paying a taxable dividend (or perhaps deferred compensation) to the client's wife.*

*When the policy (or an interest in a policy) is transferred for a valuable consideration to a non-exempt party, the lion's share of the death benefit may be income taxable to the beneficiary. The rules governing when a transfer for value has occurred are complex, but where such a transfer has occurred and there is no exemption available, every effort should be made to correct the situation.*

*If a policy is defined as "employer-owned," was issued after August 17<sup>th</sup>, 2006, and the notice and consent requirements of § 101(j) have not been met, the death benefit (minus premiums paid) paid to the company at the employee's death will be income taxable. This failure must be cured in some way, typically by increasing the face amount of the existing policy or by putting new coverage in place if the employer does not wish the death benefit to be taxable.*

- Estate tax inclusion
- Are the owner, beneficiary, and insured three different people/entities?
- Dividend problems-i.e., corporate owner/personal beneficiary
- Transfer for value problems
- Employer-owned life insurance

#### H. Distribution issues

*Make certain to ask the client who should receive the proceeds, when, and under what circumstances. Many clients may be under the misconception that beneficiaries must be named individually to receive proceeds outright in a lump sum. Many would be interested in hearing how a living, revocable trust can be used to control distribution of death proceeds in accordance with the client's wishes, while also offering some asset protection for the beneficiaries.*

*If the client already has a trust set up to receive the proceeds, make sure he/she understands how its provisions will work following the client's death. If the client's objectives are not being met, either the document or the positioning of the policy may have to be changed. Always refer the client to their appropriate advisor for advice regarding tax and legal issues.*

- *Direct lump-sum payments vs. controlled distribution*
- *If trust, what does the trust provide?*
- *Using revocable trusts as beneficiaries*

#### I. Is the arrangement more or less attractive from a tax perspective than it was at the outset?

*Perhaps the policy was originally purchased by the client's C corporation to take advantage of its low 15% tax bracket. But if the corporate tax bracket has increased to 35% over time, the perceived tax advantage of this ownership arrangement may have disappeared. Or if the corporation has since filed the Selection, it may make eminently more sense for him/her to own the policy personally.*

*Sometimes changes occur simply through the passage of time. A policy in a qualified retirement plan, or under a split dollar arrangement, may have produced very low taxable term costs when it was purchased at the insured's age 39. However, at age 62 those taxable term costs may be exorbitant.*

*Often changes in the legal environment will produce very different results from those intended. For example, the client entered into a reverse split dollar agreement with his corporation back in 1994. As a result of a variety of IRS pronouncements and rulings over the next decade, reverse split dollar is no longer viable. Continued use of a strategy is in violation of several prohibitions which, if discovered upon audit, could cause the client significant discomfort, including possible increased taxes, interest, and penalties. Similarly, §409A has introduced tremendous complexity into the deferred compensation arena.*

- Changes in the nature of the entity, e.g., from C to S
- Effect of time, e.g., increased taxable term cost
- Changes in the tax law, e.g., equity or reverse split dollar

J. Has the product performed to client expectations?

*Years of declining interest rates may have affected dividend scales to a point where the client's original expectations may not be realized, e.g., the hope that the premiums could be internally funded prior to retirement. There may have been certain interest rate climates in the past where borrowing against a whole life contract under a variable loan interest rate actually enhanced dividends. However; the current reality may be that policy loans significantly reduce policy performance. UL interest crediting may have been much lower than originally protected, and a history of performance much lower than that illustrated may have eroded product values to dangerously low levels. Even if the client's risk profile suggests that the current product is still suitable, corrective action should be taken as early as possible. This may involve recommending increased funding or reductions in face amount for these contracts to avoid potential lapse down the road.*

- Effect of low interest rate environment
- Effect of actual policy values underperforming illustrated values

## K. Replacement Issues

*Replacement of existing policies is rarely recommended, and a variety of factors must be taken into account. For example, the client's health status may have declined since the existing coverage was purchased, which may well offset the supposed advantages of modern product design and more competitive pricing. Risk to the client can be managed in more ways than one: replacement of under-funded contracts may be less suitable than an infusion of additional premium payments into those policies. The "best interest of the client" must be the guiding principle. It may be helpful to consider what you would recommend to a close family member in a similar situation.*

- Client insurability
- Risk vs. guarantees
- "Best interest of the client"

## L. Objectivity in conducting audits

*The Level4Life is an opportunity to provide a valuable service to the client and develop a relationship that will be mutually beneficial in the future. This can be a great way to enhance relationships you may have with you better clients.*

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