Defusing the Tax Time Bomb

Wealth Transfer Strategies Using Qualified Funds
It is estimated that the Baby Boomers will pass more than $40 trillion in accumulated assets to their heirs by the year 2052. Welcome to the next great frontier in the financial services industry: Wealth Transfer.

Right now, $7 trillion of those dollars are accumulating tax-deferred in qualified accounts like IRAs and 401(k)s. Chances are, a significant percentage of the prospects you’re meeting with own a share of that significant total. It is also likely that some of the prospects you’re meeting with never plan to use their qualified assets as income. They’re drawing income from other sources, like a pension or Social Security, and would rather continue to defer taxes on their qualified money and let it accumulate for as long as possible.

What your clients need to understand is that tax-deferred does not mean tax-free. Whether your client takes voluntary withdrawals, or they’re forced to take Required Minimum Distributions starting at age 70 ½, or their beneficiaries pay the taxes when the money transfers to them; One way or another, the government is going to collect tax revenues from that money.

So how can your clients ensure that they’re not simply growing a larger tax burden for their children by letting these qualified assets accumulate?

This report will describe three wealth transfer strategies designed specifically to allow your clients to pass the full value of their qualified assets to their beneficiaries, while eliminating the tax burden on those beneficiaries.

The following information is considered “Explosively Important” and should be handled with care! If you’re not interested in protecting your clients from HUGE TAX BURDENS, do not read any further. You have been warned.
Wealth Transfer Strategy #1: Offsetting Income Taxes

**Summary:** Your client has a significant amount of money in an IRA. He is taking RMDs, but he doesn’t need the money for income. He would like to leave the balance of his IRA to his beneficiaries, but he’s concerned about leaving behind a large tax burden as well. In this concept, you use a portion of the unwanted RMDs to fund a life insurance policy that will help off-set the income taxes his beneficiaries will owe when the IRA is transferred to them.

**Assumptions:**
- Married couple
- Both age 70
- $1 million IRA in the husband’s name
- 6% growth rate on the IRA
- 28% tax rate for the couple and their heirs
- No withdrawals other than RMDs

**Step 1:** Determine the projected value of the IRA at a point in the future when your client expects to transfer the IRA value to his heirs.

Basically you’re determining life expectancy here, which can be done in a number of ways. You can purchase a life expectancy calculator that will take into account a variety of criteria to give the most accurate prediction. You can use a free calculator like the one at [www.livingto100.com](http://www.livingto100.com), which takes into account lifestyle factors, nutrition, body type and medical factors to predict life expectancy. Or you and your client can just select an age like 80, 85 or 90 for illustrative purposes.

In this case, let’s say the client’s life expectancy is 80. You will illustrate the IRA value at age 80 (taking into account the 6% growth rate and the RMDs) to be $1,154,424.

**Step 2:** Estimate the income tax the beneficiary will owe if the IRA is inherited as a lump sum when your client turns 80.

**continued on next page...**
If the beneficiary inherits the IRA as a lump sum, income taxes will be assessed on the entire amount. To figure out the taxes they’ll owe, just take the estimated value of the annuity at the time of transfer and multiply it by the beneficiary’s income tax rate.

<table>
<thead>
<tr>
<th>Est. Value (age 80)</th>
<th>Estimated Tax Rate</th>
<th>Taxes Owed by Beneficiary</th>
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<tbody>
<tr>
<td>$1,154,424</td>
<td>X</td>
<td>$323,239</td>
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**Step 3: Offset tax liability with life insurance.**

Use a portion of the client’s unwanted RMDs to fund a life insurance policy with a face amount equal to the beneficiary’s expected tax liability—in this case $323,239.

Your single clients might want to go with **North American’s Custom Guarantee**, which offers the performance and flexibility of universal life insurance combined with the solid guarantees associated with whole life.

**See an illustration for this case using Custom Guarantee**

Married couples might opt for **North American’s Survivorship GIUL**, which would pay the death benefit to the designated beneficiary upon the second insured’s death.

**See and illustration for this case using Survivorship GIUL**

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**Result:**
- Beneficiary receives $1,154,424 inheritance from the IRA.
- Beneficiary receives $323,239 life insurance death benefit, which is used to pay the tax liability owed on the IRA.
- The asset transfers, essentially, with no tax liability for the beneficiary.
- And the life insurance didn’t cost your client anything “out-of-pocket” because he simply leveraged the RMDs he was taking anyway. Rather than putting them in the bank, he simply committed a portion of them to paying his life insurance premiums.
Wealth Transfer Strategy #2: Eliminating Income Taxes

**Summary:** Your client has a significant amount of money in an IRA. He is taking RMDs, but he doesn’t need them for income. He would like to leave the IRA to his beneficiaries, but he’s concerned about leaving them a large tax burden as well. In this concept, you take the unwanted RMDs and use them to fund a life insurance policy that will transfer to the beneficiary tax free. Then your client names a charity of his choice as the beneficiary of his IRA.

**Assumptions:**
- Married couple
- Both age 70
- $1 million IRA in the husband’s name
- 6% growth rate on the IRA
- 28% tax rate for the couple and their heirs
- No withdrawals other than RMDs

**Step 1:** Determine the projected value of the IRA at a point in the future when your client expects to transfer the IRA value to his heirs.

Once again, you’re basically determining life expectancy here. Refer to Page 2 for tips on how to do this. In this case, let’s say the client's life expectancy is 80. You will illustrate the IRA value at age 80 (taking into account the 6% growth rate and the RMDs) to be $1,154,424.

**Step 2:** Replace IRA inheritance with a life insurance policy.

The client will use all or part of his RMDs to purchase a life insurance policy, naming a loved one as the beneficiary, with a face amount equal to the projected value of the IRA at age 80: $1,154,424.

The life insurance death benefit will pass to the beneficiary income-tax free.
Your single clients might want to go with **North American’s Custom Guarantee**, which offers the performance and flexibility of universal life insurance combined with the solid guarantees associated with whole life.

**See an illustration for this case using Custom Guarantee**

Married couples might opt for North American’s Survivorship GIUL, which would pay the death benefit to the designated beneficiary upon the second insured’s death.

**See an illustration for this case using Survivorship GIUL**

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<th>Year</th>
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<th>Premium</th>
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**Step 3:** Name a charity as beneficiary of the IRA.

Your client then names a charity of his choice as the beneficiary of the IRA. Charities are exempt from paying income taxes, so this essentially eliminates the tax obligation that would normally exist on the IRA.

By giving the IRA away as a charitable gift, your client could also reduce the overall value of his estate and consequently reduce any applicable estate taxes.
Result:

- Beneficiary receives $1,154,424 tax-free death benefit
- IRA transfers to the client’s favorite charity, also tax-free
- The client reduces the value of his overall estate
- And the life insurance didn’t cost your client anything “out-of-pocket” because he simply leveraged the RMDS he was taking anyway. Rather than putting them in the bank, he simply committed a portion of them to paying his life insurance premiums.
Wealth Transfer Strategy #3: Creating Multi-Generational Wealth

Summary: Your client has a significant amount of money in an IRA. He is taking RMDs, but he doesn’t need the money for income. He would like to leave the IRA to his beneficiaries, but he wants to make sure he’s maximizing the potential payout not only his children receive, but also his grandchildren. In this concept you execute a “Stretch IRA” and use the unwanted RMDs to fund a survivorship life insurance policy, naming his children as the beneficiaries.

Assumptions:
• Married couple
• Both age 70
• $1 million IRA in the husband’s name
• 6% growth rate on the IRA
• 28% tax rate for the couple and their heirs
• No withdrawals other than RMDs

Standard IRA Distribution Plan

Here is the way most IRA distributions plans work. The spouse is designated as the primary beneficiary. So when the IRA owner dies the spouse does an IRA rollover into his or her own account, continuing the tax deferral and taking the RMDs. Typically, the children then become the beneficiaries.

When the children eventually inherit the IRA, the number of years they can defer the taxes is based on their age at the time of inheritance. If the children pass away before the end of their maximum deferral period, their beneficiaries—typically the grandchildren of the original IRA owner—inherit the balance of the funds and the balance of the deceased child’s deferral period.
For example, if the child had a maximum deferral period of 25 years and they die 20 years in, their beneficiary will only be able to defer taxes for the remaining five years.

Figure 1: Standard IRA Distribution

Multi-Generation IRA Distribution Plan

By making some simple changes to their IRA beneficiary designations, your clients would be able to base the maximum deferral period on the grandchildren’s life expectancy, rather than their children’s, dramatically increasing the years of tax deferral and the total benefit.

Figure 2: Multi-Generation IRA Distribution
Step 1: Determine the projected value of the IRA at a point in the future when the surviving spouse expects to transfer the IRA to his or her grandchildren.

Once again, you’re basically determining life expectancy here. Refer to Page 2 for tips on how to do this. In this case, let’s say the client’s life expectancy is 85. You will illustrate the IRA value at age 85 (taking into account the 6% growth rate and the RMDs) to be $1,124,385.

Step 2: Replace IRA inheritance with a life insurance policy

The client will use all or part of his RMDs to purchase a survivorship or “second-to-die” life insurance policy, naming a loved one as beneficiary with a face amount equal to the projected value of the IRA at age 85: $1,124,385.

Now, instead of receiving the balance of the IRA, which they would have had to pay income taxes on, the beneficiary receives a life insurance death benefit that is income-tax free.

See an illustration for this case using Survivorship GiUL

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Step 3: Change the designated beneficiary on the IRA from the children to the grandchildren

Remember, while both spouses are still alive, the beneficiary remains the spouse. It is only after the IRA has transferred from the IRA owner to the surviving spouse that the grandchildren become the beneficiaries.

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Results:
By doing the Stretch IRA distribution, you can actually increase the projected distribution on your client's $1 million IRA from $3,710,145 to $12,263,120!

<table>
<thead>
<tr>
<th></th>
<th>Standard Plan</th>
<th>Stretch Plan</th>
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<tbody>
<tr>
<td><strong>Projected Distributions:</strong></td>
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<td>During Original Owner’s lifetime:</td>
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<td>$531,549</td>
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<tr>
<td>During Spouse’s lifetime:</td>
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<tr>
<td>During Children’s lifetime:</td>
<td>$2,824,920</td>
<td>$10,592,138</td>
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<tr>
<td><strong>Total Distribution</strong></td>
<td>$3,710,145</td>
<td>$12,263,120</td>
</tr>
</tbody>
</table>

By helping your clients take advantage of one of these three strategies, you're helping them leverage an asset they're weren't imminently using, helping them achieve a tax-efficient transfer of their assets, and helping alleviate the tax burden on their beneficiaries—which, in turn, will make subsequent generations more likely to want to do business with you.

This should go without saying, but with these strategies it is critically important to get the spouse and children involved so they have a clear understanding of the client's goals for the money and the solution you're putting in place to make sure that goal is being met.

Call Senior Market Sales with your next wealth transfer case and we'll run an illustration for you using one of North American's universal life products.

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