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TFS Insurance Advisor

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- Case Study: Estate Planning
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Deferring Taxes to Accelerate Growth

With the conclusion of each tax season, many Americans reflect on how much more they pay in taxes every year. It quickly becomes clear how taxes paid on capital gains, dividends, and interest can quickly erode portfolio return. With tax season approaching, here is something to think about:

What if you had a chance to increase the return potential of your money without adding to risk? Would you take it? That's precisely what can happen in accounts that can defer taxes until the assets are withdrawn. While taxes cannot be eliminated from a tax-deferred account, they can be controlled.

What Is Tax Deferral?

Tax deferral refers to earnings such as interest, dividends, or capital gains that accumulate tax free until the investor withdraws the amounts. The most common types of tax-deferred products include those in individual retirement accounts (IRAs) and tax-deferred annuities.

How Does It Benefit Investors?

By deferring taxes on the returns of an asset, the investor benefits in two ways:

1. **Tax-Free Growth:** Instead of paying tax on the returns of an asset, tax is paid only at a later date, leaving the asset to grow unhindered.
2. **Good Demographic Timing:** Most retirement contributions are made while the individual earns income at a higher tax rate—during prime working years. Conversely, individuals receive income in retirement when they are earning substantially less income, and, consequently, may be taxed at a lower rate.

For Future Retirement Expenses, the Longer Taxes Are Deferred, the Better

For example, a $100,000 contribution that earned a 4% average annual rate of return in the 25% tax bracket would have grown to $180,611 over 20 years. In contrast, a $100,000 tax-deferred contribution that earned 4% over the same time period would have grown to $219,112 — a $38,501 advantage.

How to Combine Tax Deferral with Guaranteed Income Payments

While tax-deferred annuities can be fairly straightforward—pay an insurance company today to insure income in the future—they have become more flexible and diverse over the years. In 1995, for example, the insurance industry introduced the fixed index annuity (FIA) to pay interest based on the performance of a market index such as the S&P 500®.[1]

While an FIA is usually subject to income tax paid when withdrawals are made, investors can have the benefit of tax-deferral to earn interest on their principal, credited interest, and savings from tax deferral.

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Case Study: Estate Planning

Tom and Emily Swanson are civil engineers—Tom is a highway engineer and Emily is a structural engineer. They both have substantial, fulfilling, and well-paying jobs. However, they have a strong interest in starting their own engineering firm sometime in the future. They realize such a new venture would require start-up funds.

Both have done extensive work with local, state, and neighboring state governmental agencies. They have a knack for coming up with very competitive job bids that have also been very profitable for their employer, and Emily's bridge design innovations have won her national recognition both for aesthetic attractiveness and structural superiority.

The Swansons are a bright, highly motivated couple with a strong entrepreneurial spirit and two young children.

Although they have a mortgage, they've built $75,000 of equity in their house. In addition to $300,000 in their 401(k) plans, the Swansons have $15,000 in savings and a 529 plan for each of their two children established by Tom's parents. They also each have $175,000 of group term life insurance.

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Growing Tax-Deferred Interest across Different "Buckets"

FIAs offer a variety of options for earning interest, too, which investors can adjust if their objectives or circumstances change. Think of these accounts as different "buckets" that represent different vehicles for your money.

Bucket 1

Fixed Account

The first bucket might be a fixed-rate account that pays a guaranteed rate for a specified period of time. Amounts allocated to this option would be credited with an interest rate that is current on the date the solution is effective. This is typically a good choice for investors who want to know at the beginning of the year how much interest will be credited to their account.

Bucket 2

Domestic Equities

For investors who want to participate in the performance of the broad U.S. market, another bucket could be linked to the S&P 500® Index, which is widely regarded as a premier benchmark for the domestic stock market.

Bucket 3

International Equities

Investors who want international equity exposure might also want an allocation across a broad array of global equity markets and selected industry sectors.

Bucket 4

Risk-Managed Momentum

For investors who want exposure to an even wider variety of asset classes beyond equities, other strategies are available. Multi-asset strategies can allocate across equities, gold, interest rates and cash in an effort to outperform fixed-weight portfolios by dynamically allocating more to assets that show upward momentum. A volatility control mechanism in such cases is often used to help manage downside risk, as well.

Flexible Tax-Deferred Choices that Grow Your Savings

Such indexed account buckets offer these advantages:

- If an index turns negative during a term, an account cannot be credited below 0%.
- On the other hand, with positive index performance, an account has the potential to receive credit increases.
- Since an indexed account can never earn a negative interest rate, an account can experience positive growth when an index rebounds.

Regarding income payouts, please keep in mind that annuity guarantees are subject to the claims-paying ability of the issuing insurance company.

For the Retirement Dimensions in Your Life: Growth Today for Income Tomorrow

If you are like many individuals nearing or entering retirement, you are looking to achieve two primary goals: Accumulate dollars today and receive dependable income tomorrow.

The journey between those goals, however, may involve unwanted risk exposure unless you have adequate information, expert advice, and access to proven strategies. One strategy you may want to consider to secure a sustainable retirement lifestyle is a proven, cornerstone financial product like an FIA.

An FIA, in effect, is a contract between you and an insurance company that is designed to help you meet your long-term retirement needs. In exchange for your purchase payment (premium), the insurance company gives you the opportunity to earn additional interest based on the performance of a market index, and pays you income in the future.

1 LIMRA US Individual Annuity Yearbook – 2011

Life Insurance as a Bonding Asset

What are bonding assets?

Many companies have to keep liquid assets on their books for bonding purposes. Contractors and construction companies in particular must do this as a condition of certain agreements. There are many different types of bonds with varying requirements. And, contractors are often required to purchase them to protect against any number of adverse events. These events may include disruptions in a project, failure to complete a project due to insolvency of the contractor(s), or the project's failure to meet contract specifications.

While each situation is unique, assets set aside are often significant and are often a subject of frustration to the contractor. Corporate-owned life insurance (COLI) may offer an efficient way to allow these assets to serve multiple functions.

The power of COLI as a multi-purpose asset

COLI policies have traditionally been available only to larger companies for benefit funding. But, they're often attractive to all sizes of businesses for these reasons:

- **Death benefit protection** – This helps protect against any interruption in operations an owner's death may cause. The survivor benefit may be shared between the business and the business owner (for personal protection) in whatever proportions make sense.
- **Business protection** – The policy may be used for multiple purposes. These may include key person protection, buy-sell funding and key employee benefits. At the owner's retirement, the policy may also be distributed and used for tax-advantaged retirement income.
- **Balance sheet enhancement** – Generally these policies have cash values approximately equal to premiums paid.
- **Tax-advantaged growth** – Because life insurance cash values grow tax-free, they don't create taxable income.

Bonding assets held in reserve are frequently limited to certain types of cash and equivalents. However, COLI policies can provide the business owner with additional personal and business benefits not available with other assets.

Company receives important death benefit protection

Under a typical structure, the business owns the policy and uses the cash held as a bonding asset as the source of policy premiums. So, there's little net impact to the balance sheet. Policy cash surrender values show up on the balance sheet as an asset for bonding purposes. The business is named beneficiary of the policy's income tax-free death benefit. This may provide a boost to the balance sheet if the business owner dies during his/her working years, thus providing liquidity to meet other business obligations.

Death benefit provides additional protection to the company, its owner and key employees, and the company's bonding provider.

Hypothetical comparison shows benefits of using life insurance

Let's walk through a quick example using a hypothetical 10-year universal life insurance policy (standard underwriting). Assume a 55-year-old business owner wishes to contribute $100,000 of incoming revenue to an insurance asset ($20,000/year over five years allocated to a conservative universal life insurance policy). The policy death benefit for this would be approximately $300,000. Take a look at the potential results in Year 10:

Year	Cumulative premium	Cash value of asset	Cumulative net cost
1	$20,000	$19,690	$(310)
5	$100,000	$99,785	$(215)
10	$100,000	**$109,175**	$9,175

Now assume the business owner instead purchases a hypothetical $300,000 term life insurance policy, with $100,000 of incoming revenue. After the premium is paid, the remainder is allocated to a cash account

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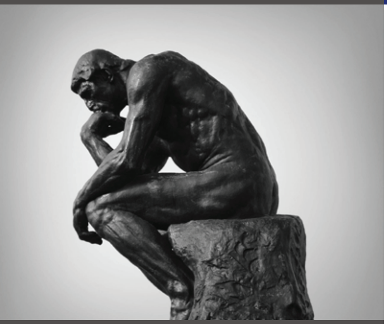
Emily is painfully aware of the problems caused by a death in the family. She watched her best friend Sarah struggle with debts, medical expenses, funeral costs, attorney fees, probate costs, and taxes when her 43-year-old husband passed away due to cancer.

She was profoundly affected by Sarah's experience with settling her husband's estate, and it prompted her to ask for some advice about their personal situation.

1. **Create an immediate solution with life insurance that can provide both estate liquidity and supplemental income to meet family needs.**
2. **Use the life insurance policy to build cash value that can be accessed when they start a new venture or used as collateral for a bank loan.[1]**

Because they do not have a federal estate tax issue, the policies on each of them can be personally owned. A $500,000 policy on each of them would provide immediate estate liquidity, a family income source, and a reserve fund for opportunities in the future.

1 Loans or partial withdrawals can reduce the policy's cash value and death benefit, can increase the possibility of policy lapse, and may result in a tax liability. Consult a tax advisor for additional information on the tax treatment of loans or withdrawals from a life insurance policy.



HERE'S A THOUGHT...

"Compound interest is the eight wonder of the world. He who understands it, earns it."

- Albert Einstein

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earning 1%. A quick comparison shows the universal life insurance policy generates more cash-value potential for the bonding asset.

Year	Cumulative premium	Cash value of asset	Cumulative net cost
1	$803	$19,397	$(603)
5	$4,015	$98,444	$(1,556)
10	$8,030	$99,895	$(105)

The longer the policy is in place, the greater the benefits are realized.

Could a business owner's family receive a death benefit?

There may be additional death benefit dollars not needed by the business. Then, the owner can arrange to have it payable to his or her family or to an irrevocable life insurance trust through a simple endorsement. This results in a small amount of taxable income that will appear on the owner's tax forms. It's necessary to keep the death benefit income tax-free.

Could an owner benefit personally from this arrangement?

At a point when the policy is no longer needed by the business, the policy may be distributed (or transferred) to the owner. He or she may be subject to income tax at the time of transfer, but may then use the policy as a tax-advantaged source of retirement income.

Life insurance has both a death benefit and cash value element which makes it a versatile corporate asset. And, although the death benefit can protect the company from unplanned events in both the short and long term, the cash value element should be viewed as a long-term asset. And, one important final note. There are many types of bonding arrangements. Ultimately, it's the decision of the bonding provider to determine if it's appropriate to use life insurance as an alternative or supplement to other assets.

Source: Principal National Life — Not FDIC or NCUA insured

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