THY WILL BE DONE by Atty. Angelo M. Cabrera

The insurance option in estate planning

In my last few articles, I discussed the various tools that estate owners use in avoiding estate tax and their possible effects on both the family and their wealth. Many of these instruments involve the premature transfer of property ownership from the estate owner to the children.

One of the main reasons why an estate owner would consider lifetime transfers is because of the wrong notion that estate planning is only about tax avoidance, that is, avoiding at all cost the need for the heirs to shell out money just to inherit one's wealth.

But what if money could be made available to pay the tax liability when the time comes? What if the estate plan includes an instrument which could generate the money needed to settle the estate tax?

Wouldn't it allow the estate owner to continue to hold on to his properties and pass them on only at the proper time? Wouldn't it allow him to retain control of his wealth and provide him with the flexibility to do with it as he pleases? And wouldn't it also allow him to enjoy his hard earned wealth until the very end without fear of being completely dispossessed with a sudden change in circumstances as when one relinquishes ownership?

This option will involve the use of a plan that is precisely designed to address the cash needs of a family at the time of death – life insurance.

The good thing about life insurance is that, even as estate tax is triggered by the death of the estate owner, the same death triggers the release of the life insurance benefit. The timing couldn't be more perfect.

Here's how it works: By getting a life insurance coverage equivalent to the expected estate tax liability, cash shall be made available at the precise time that estate tax becomes due. For instance, if the projected estate tax is computed at 20 million if one were to go today, it means that he has to be insured for 20 million and pay only the corresponding premiums.

Now doesn't that make sense? Why transfer your wealth today and pay the transfer taxes such as donor's or capital gains tax, when you can simply take out an insurance policy at a fraction of the tax that you are willing to pay for anyway?

Many people do not realize the value and importance of life insurance because of the notion that it simply is another expense. What is oftentimes overlooked is that life insurance is the only plan that is precisely designed to deliver cash at the time of death – whether to provide for the needs of a family, which just lost its breadwinner or for the timely settlement of estate taxes.

Some argue that they have money in the bank to pay for taxes anyway. The problem with this is that bank deposits are required to be frozen by the bank upon its knowledge of the death of the depositor unless estate taxes have been paid (Sec. 97, Tax Code). Now compare this with life insurance, which by its very character requires the release of money upon death of the insured. Besides, why let your heirs pay 20 million in estate taxes with your own funds when the same amount can be sourced from another fund, at a cost much less than the tax that the family will have to pay for anyway.

It is for these reasons of liquidity, immediacy and availability that one can find value in life insurance as a necessary component of estate planning. Life insurance will ensure that wealth shall be passed on, not prematurely, but at the proper time; and not reduced by taxes, but intact and undiminished since a separate fund is created for tax settlement.

Of course, this presumes that the estate owner is still insurable. One can become uninsurable by virtue of his age, health or occupation. This brings up an all-important point: the need to load up on insurance while you're qualified, that is, while you are young, healthy and with great capacity to earn. To postpone any decision on this for tomorrow means that you'll be older and probably less healthy – factors that can either drive up your premiums to prohibitive levels or make you completely uninsurable. It is always good to take advantage of your age and good health in getting an insurance coverage.

For comments or questions, you may email cabrera.am@amclawoffice.com