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INSIDE THIS ISSUE



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## RETIREMENT BENEFITS AND LIFE INSURANCE BY LETHA SGRITTA MCDOWELL

Many estate planners will focus on designating the beneficiary of qualified retirement plans. Tax rules surrounding qualified retirement plans are tricky and complex. While it is becoming more widely accepted that qualified plans can be left to a trust, many estate planners are still uncomfortable with the concept, and drafting such a trust requires careful review of trust provisions. When a client has a taxable estate, the issue of what do with the retirement benefits becomes even more important because of the tax consequences of having the qualified plan in the taxable estate. The qualified plan is subject to both the federal estate tax and income taxation on its withdrawal. Despite the opportunity to stretch a qualified plan, the total tax rate on the IRA can be devastating to the overall value of the asset.

Instead of leaving a qualified plan in the client's estate, it may be prudent to consider using the distributions to purchase life insurance. I recently had a client with a total taxable estate of approximately $5 million. The majority of her estate was comprised of two businesses, various parcels of real property, and an IRA with a value of approximately $500,000. The client is 82 years old and healthy. She had created an estate plan approximately 20 years ago and had not updated it since. At the creation of her initial estate plan, she had established and funded an Irrevocable Life Insurance Trust (ILIT) with a $1 million insurance policy. At our initial review of her estate plan, the client and I determined that it would be prudent for her to maintain the ILIT and the life insurance policy because her estate is in need of liquidity to pay any estate taxes due at her death. The client and I also reviewed her IRA and determined that her deceased husband was named as the beneficiary. She explained that she was unhappy with the fact that she had to take her yearly required minimum distribution from the IRA because she didn't need it to support her lifestyle. Additionally, she thought that her children would liquidate the IRA and use it to pay any remaining expenses and estate tax liability at her death.

When I reviewed the tax consequences of the IRA being included in her estate at her death, the client became even more frustrated with her IRA and asked me to determine what other options were available for the IRA. I looked into a variety of options, including charitable gifts and trusts, but found nothing satisfactory, until I looked into life insurance as an option.

Working with a qualified insurance professional, I determined that my client was entitled to a preferred insurance rating (even at the age of 82). I found that my client could take her IRA and purchase a single premium immediate annuity that would provide her with income of approximately $70,000 per year for the rest of her life, or an after tax income of approximately $42,000 per year. She can then gift that $42,000 per year of income to her ILIT. That $42,000 can then be used to purchase a guaranteed premium life insurance policy of $550,000. The result of the transaction is that her estate is reduced by the value of her IRA, and an asset of slightly greater value is passed to her heirs tax free at her death.

Using this strategy, the client is able to pass an asset worth $550,000 to her heirs, whereas if the IRA is included in her gross estate, the value of the IRA would be reduced to $178,750 after both estate and income taxes are paid. This matter provided me with the valuable lesson that there are more issues and options to consider with qualified retirement benefits than just a beneficiary designation.

The attorneys at Oast & Hook can assist clients with their insurance, financial, investment, estate, veterans' benefits, long-term care and special needs planning issues.

*Letha Sgritta McDowell is an elder law attorney with Oast & Hook. She concentrates her practice in estate planning, estate and trust administration, asset protection planning, long-term care planning, Veterans benefits planning and tax planning. Ms. McDowell is licensed to practice law in North Carolina and Virginia.*

## Ask Allie

O&H: Allie, we've heard that in these difficult economic times, many families can't afford toys for their cats. Do you have some ideas for keeping cats entertained on a budget?

Allie: Sure! You may not be aware that cats were into recycling long before the word "green" became a buzzword. A recent article by Linda Lombardi of the Associated Press highlighted some cat toy suggestions. We like plastic caps from milk or juice jugs (We can shoot them like hockey pucks and send them under the refrigerator.); we also like to play with twist-ties from loaves of bread or rolls. The laser pointer is one of my favorite toys, but if you can't afford one, reflect some sunlight off of your wristwatch to make a spot of light on the walls or floor. If you are drinking more wine these days as you review your investment portfolio, save the corks for us to bat around. If you shop online, we of course will commandeer the box; if you shop in a store, we will do the same with paper bags. We don't need special cat beds; we like to sleep anywhere as long as it is on top of "stuff," including clothes and magazines. Finally, if you're reading economic news in the newspaper, and we come and sit on the paper, you may be better off playing with us! Time for my nap (on a pile of bubble wrap in one of the offices)....

Please feel free to e-mail your pet- and animal-related questions to Allie at: allie@oasthook.com.

## Announcement

Oast & Hook attorney Sandra Smith will make a presentation entitled "Estate and Long-term Care Planning" at the Wahab Public Law Library located at the Court Support Building 10B, Virginia Beach Judicial Center, 2425 Nimmo Parkway, Virginia Beach, Virginia, from noon to 1:00 p.m., Tuesday, May 19th. This presentation is free and open to the public. For more information or to register for this presentation, please phone 767-385-4419.

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