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The Looking Forward Series: April 2014

This month we are featuring an extended article by one of our partners, Gwen Baker about taxation and the value of life insurance.

Taxation & Life Insurance by Gwen Baker

There are many situations where the use of life insurance and insurance-based products can help mitigate or even eliminate many taxes. Here's an ugly reminder of additional taxes most people pay in addition to federal income tax.

1. State income taxes. Most states impose additional income taxes. Massachusetts' is 5.96%, Connecticut starts at 5% and goes up to 6.70%, California's can go as high as 12.30% for singles earning over 254,000. Check your states rates at http://www.tax-brackets.org

2. Qualified Retirement accounts shelter the growth in the account, but income from these accounts is subject to state and federal income tax rates (see above for a reminder). Taxation in retirement can have a real impact on the net income received and life insurance products can provide a tax beneficial solution to this.

3. Estate and Gift taxes: Besides the federal tax bite of over 50% after the exemption, individual states have begun to add their taxes as well. Life insurance can be the perfect vehicle to meet this need as it can provide instant liquidity 30 days after death, and almost always the proceeds of a life insurance policy are tax-free.

4. Capital Gains Taxes: Profits gained on the sale of houses, stocks, family farms and businesses and other appreciated assets are also taxed at 20% plus an additional 3.8% for higher income earners.

Life insurance and annuity products can reduce the bite of taxation while at the same time taking care of the need for protection in the event of an unexpected or premature death.

Below are some tax facts about Life Insurance:

- 1): Proceeds from life insurance policies are Tax free to the beneficiary, as long as the ownership is structured properly. Ideally, a life insurance policy should not be owned by the insured but rather by a trust or possibly the beneficiary.

- 2): Life Insurance as a Supplemental Retirement Asset: Traditional IRA's and qualified plans offer tax-free growth but are taxable at distribution. By overfunding a Permanent life insurance policy and using a life product built for accumulation you can build cash value at equity like rates, you can have tax free growth on the investment component of the life insurance, and that cash value if structured properly can provide a tax- free income stream at retirement.

- 3): Life Insurance proceeds can cover Estate taxes: Both federal and state taxes are due 9 months after death. The cost of life insurance can be a fraction of what the taxes are, and the proceeds are tax-free. While the federal exemption is $5.3 million dollars for each individual, state exemptions range from zero to 1 million. In Massachusetts 1 million is exempted and the rest of the estate is taxed at 16%, which is the same figure for New Jersey and New York. Iowa 's rate is 15% and there is a zero exemption. Each state is different, check the state you live in to see what the rate is. Taxes are calculated on the value of ALL your assets.

- 4.) Mitigating Capital Gains Taxes: Life Insurance can replace an asset that is donated to a charity at death and help even out an inheritance among children. This is far superior to just paying the capital gains tax on the sale of a highly appreciated asset. If you have a highly appreciated asset- a beach house passed down a few generations that has increased substantially in value, a family farm that has increased in value, stocks from your Grandmother that you have never touched, you can donate this asset-- house, land, stocks, to a special Trust- almost any highly appreciated asset, receive a tax deduction and replace it with life insurance, instead of paying the hefty capital gains tax. This also provides an income stream, a tax deduction and an inheritance with family members.

These are just a few ideas, a few ways that owning life insurance can mitigate taxes, and provide liquidity to cover them at death. GB Financial Group can help structure these types of solutions and many others that benefit individuals, owners of small business, and help protect the owner. Please contact us for more in depth discussions on these ideas and concepts.

Outside article this month from our friends at the AALU.

The New Playing Field – A Review of the Net Investment Income Tax and Final Regulations

Summary: The new net investment income tax ("NIIT") imposes an additional 3.8% tax on passive income received by individuals, trusts and estates. The combined impact of the NIIT and higher income tax brackets result in federal tax rates up to 43.4% on certain passive investment income. Wealth management for clients now requires long term deferred income tax planning, using annuities and life insurance, including private placement products, deferred compensation plans, charitable planning, and regrouping of business activities.

For Further Reading: http://www.gbfinancial.com/wp-content/uploads/2014/04/The-New-Playing-Field-A-Review-of-the-Net-Investment-Income-Tax-and-Final-Regulations.pdf