**ESTATE PLANNING: EXCESS SOCIAL SECURITY BENEFITS AND LIFE INSURANCE**

Affluent individuals who are nearing retirement or already retired may realize that they do not need their social security income.1 They have brokerage accounts, pension plans, and other assets that they feel are sufficient for their own retirement needs. But, because social security is not a needs based program, these clients will still receive their benefits in retirement. However, these same clients may be concerned about leaving a legacy for their children or grandchildren. Although they are fortunate enough to receive a social security benefit, they may not be confident that social security will remain viable to assist their children’s retirement.

These individuals who do not need their social security can either save it or use the social security income to purchase a life insurance policy. If they choose to save their social security income into a side fund, they would have to consider taxes affecting the side fund, a premature death which could mean less money to their heirs, and additional long-term care or chronic illness needs. Life insurance can provide tax benefits, an attractive rate of return at life expectancy, and can be structured to offer long-term care and chronic illness benefits. 2

The first step in this type of strategy is to identify the social security income that is not needed. The client should factor in future needs — have they considered inflation? Have they factored in potential long-term care needs?

The second step is to create a plan for the excess Social Security Income (SSI). The client can either save the SSI in a side fund (and invest it into CDs, mutual funds, bonds, etc.) or they can use the SSI to fund a life insurance policy. By saving the money into a side fund, the money would always be accessible to the client. If the client were to pass away in the earlier years though, the benefit received by their heirs would be small. In addition, the side fund would most likely have income tax consequences.

The client can potentially increase the amount to heirs if they purchase a life insurance policy with the SSI instead. In addition, the death benefit is usually received on a tax-free basis. The cash surrender value of the life policy would also grow tax deferred. If needed, tax free distributions could be taken through withdrawals and loans.3 In addition, for clients who are concerned with long-term care costs, a long-term care or chronic illness rider might be a solution.

If estate taxes are a concern, the client could create an Irrevocable Life Insurance Trust (ILIT). At death, the policy death benefit will pass to the ILIT, free of estate and income tax. 4

Life insurance, of course, comes with its unique benefits and considerations.5 It is important to understand the specifics of any life insurance policy that is purchased and to fully evaluate the risks associated with that product type, illustrated funding arrangement, and the issuing company ratings and stability. 6

EXCESS SOCIAL SECURITY BENFITS AND LIFE INSURANCE PLANNING CASE STUDY

**LIL**

**LCASE STUDY:** PERCIVAL AND HOLLY DARTIE

## CLIENTS: Robert and Ann Schultz

**STATUS:** Ages 67 and 63, Preferred Non Smokers. Robert and Ann have an estimated monthly Social Security Benefit of $2,500 before taxes ($19,000 annually after taxes), and they have plenty of retirement income coming in from a pension and other retirement accounts.

**PRODUCT:** They purchase a Current Assumption Survivorship Universal Life policy, which buys approximately $1.7M of death benefit using a premium of approximately $19,000.

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| --- | --- | --- |
| **EFFECTS OF USING SOCIAL SECURITY BENEFITS TO FUND LIFE INSURANCE** | | |
|  | **CURRENT STRATEGY** | **PROPOSED STRATEGY** |
| Social Security Benefit  Consumer Price Index (i.e. Benefit Inflation Rate) |  | |
| Approximate Total Premiums Paid by Year 29 |
| Side Fund in Year 29 (A/T Growth rate of 2%) Approximate Death Benefit in Year 29 |
| **Net to Heirs in Year 29** |
| **Potential Gain Due from Planning** |

$2,500 1.00%

$2,500 1.00%

– $551,000

$877,831 $126,037

$1,700,000

## $877,831 $1,826,037

– **$948,206**

The figures used in this case study are hypothetical, for discussion purposes only, are not guaranteed and may not be used to project or predict results. Actual results may be more or less favorable. Specific product and policy elements would be found in a policy illustration provided by an insurer. With any decision regarding the purchase of life insurance, a client would need to determine which type of life insurance product is most suitable for their specific needs.

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.

To Determine Type of Contract

1. Attitude toward risk – determine need for guarantees and suitability for variable life.
2. Possible need for lifetime distributions – determine need for long-term care or chronic illness rider.
3. Income – determine eligibility for insurance and suitability of product type.
4. New worth – determine eligibility for insurance and suitability of product type.

CROSS REFERENCES TO SOCIAL SECURITY & MEDICARE FACTS (2014)

Q 1- Q27- Understanding and Planning for Social Security

Q 136-Q 149- Social Security Coverage

Q 150-Q 165- Filing for Benefits

Q 166-Q 196- Benefit Computation

Q 197-Q 206- Loss of Benefits Because of “Excess” Earnings

Q 207-Q 215- Taxation of Social Security Benefits

FN1. See a discussion of considerations for determining when to begin taking Social Security benefits on page 311.

FN2. See a discussion of Long-Term Care Combination Products at pages 458-459. Long term care riders and chronic illness riders are similar in many ways, but they are not identical. Moreover, there are significant differences even among long-term care or chronic illness riders. It is important to understand the differences between the various types of living benefit riders that have become very common in the market-place because of the continually increasing cost of stand-alone long-term care products and the high cost of long term care.

FN3. Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income.

FN4. See a discussion of life insurance trust planning on pages 50-53.

FN5. The potential benefits of using excess social security benefits to purchase life insurance for your heirs includes life insurance can increase the amount left to heirs, life insurance cash surrender values grow tax deferred and cash values can be accessed tax-free through loans and withdrawals, and the death benefit can be received tax free. Also, depending upon state law (see discussion of life insurance creditor protection by state on pages xxx), life insurance policies may enjoy creditor protection.

FN6. See a discussion of life insurance products at pages 74 – 77. See also a discussion of life insurance company ratings at pages XXX.