OnWealth
Financial Advice from Wealth Management Services

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Life Insurance Options After Retirement

Life insurance can serve many valuable purposes during your life. However, once you've retired, you may no longer feel the need to keep your life insurance, or the cost of maintaining the policy may have become too expensive. In these cases, you might be tempted to abandon the policy or surrender your life insurance coverage. But there are other alternatives to consider as well.

Lapse or surrender

If you have term life insurance, you generally will receive nothing in return if you surrender the policy or let it lapse by not paying premiums. On the other hand, if you own permanent life insurance, the policy may have a cash surrender value (CSV), which you can receive upon surrendering the insurance. If you surrender your cash value life insurance policy, any gain (generally, the excess of your CSV over the cumulative amount of premium paid) resulting from the surrender will be subject to federal (and possibly state) income tax. Also, surrendering your policy prematurely may result in surrender charges, which can reduce your CSV.

Exchange the old policy

Another option is to exchange your existing life insurance policy for either a new life insurance policy or another type of insurance product. The federal tax code allows you to exchange one life insurance policy for another life insurance policy, an endowment policy, an annuity, or a qualified long-term care policy without triggering current tax liability. This is known as an IRC Section 1035 exchange. You must follow IRS rules when making the exchange, particularly the requirement that the exchange must be made directly between the insurance company that issued the old policy and the company issuing the new policy or contract. Also, the rules governing 1035 exchanges are complex, and you may incur surrender charges from your current life insurance policy. In addition, you may be subject to new sales, mortality, expense, and surrender charges for the new policy, which can be very substantial and may last for many years afterward.

Lower the premium

If the premium cost of your current life insurance policy is an issue, you may be able to reduce the death benefit, lowering the premium cost in the process. Or you can try to exchange your current policy for a policy with a lower premium cost. But you may not qualify for a new policy because of your age, health problems, or other reasons.

Stream of income

You may be able to exchange the CSV of a permanent life insurance policy for an immediate annuity, which can provide a stream of income for a predetermined period of time or for the rest of your life. Each annuity payment will be apportioned between taxable gain and nontaxable return of capital. You should be aware that by exchanging the CSV for an annuity, you will be giving up the death benefit, and annuity contracts generally have fees and expenses, limitations, exclusions, and termination provisions. Also, any annuity guarantees are contingent on the claims-paying ability and financial strength of the issuing insurance company.

Long-term care

Another potential option is to exchange your life insurance policy for a tax-qualified long-term care insurance (LTCI) policy, provided that the exchange meets IRC Section 1035 requirements. Any taxable gain in the CSV is deferred in the long-term care policy, and benefits paid from the tax-qualified LTCI policy are received tax free. But you may not be able to find a LTCI policy that accepts lump-sum premium payments, in which case you'd have to make several partial exchanges from the CSV of your existing life insurance policy to the long-term care policy provider to cover the annual premium cost.

A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the policy. It should be noted that carriers have the discretion to raise their rates and remove their products from the marketplace.

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Life Insurance Options After Retirement
Should You Buy or Lease Your Next Vehicle?
Step-Up GRATs and QPRTs
Can I make charitable contributions from my IRA in 2016?

Should You Buy or Lease Your Next Vehicle?

After declining dramatically a few years ago, auto sales are up, leasing offers are back, and incentives and deals abound. So if you're in the market for a new vehicle, should you buy it or lease it? To decide, you'll need to consider how each option fits into your lifestyle and your budget. This chart shows some points to compare.

Buying or leasing tips

- *Shop wisely. Advertised deals may be too good to be true once you read the fine print. To qualify for the deal, you may need to meet certain requirements, or pay more money up front.*
- *To get the best deal, be prepared to negotiate the price of the vehicle and the terms of any loan or lease offer.*
- *Read any contract you're asked to sign, and make sure you understand any terms or conditions.*
- *Calculate both the short-term and long-term costs associated with each option.*

	Buying considerations	**Leasing considerations**
Ownership	When the vehicle is paid for, it's yours. You can keep it as long as you want, and any retained value (equity) is yours to keep.	You don't own the car--the leasing company does. You must return the vehicle at the end of the lease or choose to buy it at a predetermined residual value; you have no equity.
Monthly payments	You will have a monthly payment if you finance it; the payment will vary based on the amount financed, the interest rate, and the loan term.	When comparing similar vehicles with equal costs, the monthly payment for a lease is typically significantly lower than a loan payment. This may enable you to drive a more expensive vehicle.
Mileage	Drive as many miles as you want; a vehicle with higher mileage, though, may be worth less when you trade in or sell your vehicle.	Your lease will spell out how many miles you can drive before excess mileage charges apply (typical mileage limits range from 12,000 to 15,000).
Maintenance	When you sell your vehicle, condition matters, so you may receive less if it hasn't been well maintained. As your vehicle ages, repair bills may be greater, something you generally won't encounter if you lease.	You generally have to service the vehicle according to the manufacturer's recommendations. You'll also need to return your vehicle with normal wear and tear (according to the leasing company's definition), so you may be charged for dents and scratches that seem insignificant.
Up-front costs	These may include the total negotiated cost of the vehicle (or a down payment on that cost), taxes, title, and insurance.	Inception fees may include an acquisition fee, a capitalized cost reduction amount (down payment), security deposit, first month's payment, taxes, and title fees.
Value	You'll need to consider resale value. All vehicles depreciate, but some depreciate faster than others. If you decide to trade in or sell the vehicle, any value left will be money in your pocket, so it may pay off to choose a vehicle that holds its value.	A vehicle that holds its value is generally less expensive to lease because your payment is based on the predicted depreciation. And because you're returning it at the end of the lease, you don't need to worry about owning a depreciating asset.
Insurance	If your vehicle is financed, the lien holder may require you to carry a certain amount of insurance; otherwise, the amount of insurance you'll need will depend on personal factors and state insurance requirements.	You'll be required to carry a certain amount of insurance, sometimes more than if you bought the vehicle. Many leases require GAP insurance that covers the difference between an insurance payout and the vehicle's value if your vehicle is stolen or totaled. GAP insurance may be included in the lease.
The end of the road	You may want to sell or trade in the vehicle, but the timing is up to you. If you want, you can keep the vehicle for many years, or sell it whenever you need the cash.	At the end of the lease, you must return the vehicle or opt to buy it according to the lease terms. Returning the vehicle early may be an option, but it's likely you'll pay a hefty fee to do so. If you still need a vehicle, you'll need to start the leasing (or buying) process all over.

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Step-Up GRATs and QPRTs

If you are married, a step-up GRAT or QPRT can be used to obtain a stepped-up income tax basis for appreciated property, regardless of which spouse dies first. A higher basis can reduce or eliminate the amount of gain recognized for income tax purposes on a subsequent sale of the property.

Note: Appreciation and gains are not guaranteed; depreciation and losses are possible. Payments from trusts are not guaranteed. There are fees and expenses associated with the creation of trusts.

A traditional grantor retained annuity trust (GRAT) or a traditional qualified personal residence trust (QPRT) can be used to obtain a valuation discount for federal gift tax purposes while removing the trust property from your estate for federal estate tax purposes (if you survive the trust term). By modifying a few trust provisions, a step-up GRAT or QPRT can be used instead to obtain a stepped-up income tax basis for appreciated property, regardless of whether you or your spouse dies first. If you are considering a GRAT or a QPRT, you should consult an estate planning attorney.

What is income tax basis?

Income tax basis is the base figure used to determine whether capital gain or loss is recognized on the sale of property for income tax purposes. Initially, basis is typically equal to the amount you paid for property, but adjustments may be made. If the property is sold for more than its adjusted basis, there is a gain. If the property is sold for less than its adjusted basis, there is a loss.

What is a stepped-up basis for inherited property?

When your heirs receive property from you at your death, they generally receive an initial basis in property equal to its fair market value (FMV). The FMV is established on the date of your death, or sometimes on an alternate valuation date six months after your death. This is often referred to as a "stepped-up basis" because basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

There is no step-up (or step-down) in basis for income in respect of a decedent (IRD). IRD is certain income that was not properly includable in taxable income for the year of the decedent's death or in a prior year. In other words, it is income that has not yet been taxed. Examples of IRD include installment payments and retirement accounts.

A step-up in basis is not available if you give appreciated property to anyone within one year of that person's death and the property then passes to you (or your spouse).

Both spouses' shares of community property qualify for a step-up (or step-down) in basis upon the death of the first spouse to die.

So how can you and your spouse be fairly certain of a step-up in basis for appreciated property (excluding IRD, which cannot be stepped up), regardless of who dies first? Except for community property, whether there is a step-up in basis when the first spouse dies generally depends on that spouse owning the appreciated property at death. A couple of step-up trusts may help provide for a step-up in basis for appreciated property no matter which of you dies first.

What is a traditional GRAT or QPRT?

In a traditional GRAT, you transfer property to the trust and retain a right to a stream of payments from the trust for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries (such as your children). The gift of the remainder interest is discounted (possibly to zero) because it will be received in the future.

With a traditional QPRT, you transfer your personal residence (it can be a vacation home or a second residence) to the trust, while retaining the right to live in the residence for a term of years. After the trust term ends, the personal residence passes to your beneficiaries (such as your children). The gift of the remainder interest is discounted because it will be received in the future. If you wish to live in the residence after the trust term ends, you need to pay rent at fair market value.

How do you turn a traditional GRAT or QPRT into a step-up GRAT or QPRT?

In order to turn a traditional GRAT or QPRT into a step-up GRAT or QPRT, a few trust provisions must be changed when the trust is created. First, the trust should terminate upon the earlier of the death of you or your spouse (rather than at the end of a term of years). Second, the trust should provide that when that death occurs, the trust property would pass to your spouse, or to your spouse's estate if your spouse predeceases you (rather than to other beneficiaries). Your spouse provides in a will that the property in his or her estate passes back to you if your spouse predeceases you.

The initial transfer of a remainder interest in the trust to your spouse generally qualifies for the marital deduction for gift tax purposes.

If you die first, all or a substantial portion of the property in the step-up GRAT or QPRT will generally be included in your estate and receive a step-up in basis. If your spouse dies first, all of the property in the step-up GRAT or QPRT will be included in your spouse's estate and will generally receive a step-up in basis. In either case, the property passes to the surviving spouse and should generally qualify for the marital deduction and avoid estate tax.

Caution: *If your spouse dies first and within one year of your transfer to the trust, a step-up in basis is not available because the property passes back to you.*

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discussed with an appropriate professional.

Can I make charitable contributions from my IRA in 2016?

Yes, if you qualify. The law authorizing qualified charitable distributions, or QCDs, has recently been made permanent by the Protecting Americans from Tax Hikes (PATH) Act of 2015.

You simply instruct your IRA trustee to make a distribution directly from your IRA (other than a SEP or SIMPLE) to a qualified charity. You must be 70½ or older, and the distribution must be one that would otherwise be taxable to you. You can exclude up to $100,000 of QCDs from your gross income in 2016. And if you file a joint return, your spouse (if 70½ or older) can exclude an additional $100,000 of QCDs. But you can't also deduct these QCDs as a charitable contribution on your federal income tax return--that would be double dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA in 2016, just as if you had received an actual distribution from the plan. However, distributions (including RMDs) that you actually receive from your IRA and subsequently transfer to a charity cannot qualify as QCDs.

For example, assume that your RMD for 2016 is $25,000. In June 2016, you make a $15,000 QCD to Qualified Charity A. You exclude the $15,000 QCD from your 2016 gross income. Your $15,000 QCD satisfies $15,000 of your $25,000 RMD. You'll need to withdraw another $10,000 (or make an additional QCD) by December 31, 2016, to avoid a penalty.

You could instead take a distribution from your IRA and then donate the proceeds to a charity yourself, but this would be a bit more cumbersome and possibly more expensive. You'd include the distribution in gross income and then take a corresponding income tax deduction for the charitable contribution. But the additional tax from the distribution may be more than the charitable deduction due to IRS limits. QCDs avoid all this by providing an exclusion from income for the amount paid directly from your IRA to the charity--you don't report the IRA distribution in your gross income, and you don't take a deduction for the QCD. The exclusion from gross income for QCDs also provides a tax-effective way for taxpayers who don't itemize deductions to make charitable contributions.

Can I name a charity as beneficiary of my IRA?

Yes, you can name a charity as beneficiary of your IRA, but be sure to understand the advantages and disadvantages.

Generally, a spouse, child, or other individual you designate as beneficiary of a traditional IRA must pay federal income tax on any distribution received from the IRA after your death. By contrast, if you name a charity as beneficiary, the charity will not have to pay any income tax on distributions from the IRA after your death (provided that the charity qualifies as a tax-exempt charitable organization under federal law), a significant tax advantage.

After your death, distributions of your assets to a charity generally qualify for an estate tax charitable deduction. In other words, if a charity is your sole IRA beneficiary, the full value of your IRA will be deducted from your taxable estate for purposes of determining the federal estate tax (if any) that may be due. This can also be a significant advantage if you expect the value of your taxable estate to be at or above the federal estate tax exclusion amount ($5,450,000 for 2016).

Of course, there are also nontax implications. If you name a charity as sole beneficiary of your IRA, your family members and other loved ones will obviously not receive any benefit from those IRA assets when you die . If you would like to leave some of your assets to your loved ones and some assets to charity, consider leaving your taxable retirement funds to charity and other assets to your loved ones. This may offer the most tax-efficient solution, because the charity will not have to pay any tax on the retirement funds.

If retirement funds are a major portion of your assets, another option to consider is a charitable remainder trust (CRT). A CRT can be structured to receive the funds free of income tax at your death, and then pay a (taxable) lifetime income to individuals of your choice. When those individuals die, the remaining trust assets pass to the charity. Finally, another option is to name the charity and one or more individuals as co-beneficiaries. (Note: There are fees and expenses associated with the creation of trusts.)

The legal and tax issues discussed here can be quite complex. Be sure to consult an estate planning attorney for further guidance.

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