John Hancock
LIFE INSURANCE

Sales Strategy

Qualified Plan Maximization

USING QUALIFIED PLAN ASSETS TO FUND A LIFE INSURANCE POLICY

Many of your clients have worked very hard all their lives to save for retirement. They put as much money as allowed by tax laws into their 401(k) plans, traditional IRAs, and other qualified savings vehicles. Now that they are nearing retirement, some may find that they no longer need all of these assets to supplement their retirement income. In fact, many of these clients may tell you that they plan to leave these assets alone so that their children can enjoy a larger legacy. Unfortunately, it may not be so easy for your clients to accomplish this goal.

Qualified retirement plans such as 401(k)s and traditional IRAs are an excellent way to save for retirement. They allow your clients to put away money pre-tax, and then allow that money to grow tax-deferred. However, at age 70½, your clients must start taking Required Minimum Distributions (RMDs) from their plan, whether they need the additional income or not. These RMDs will be income-taxable when withdrawn from the plan. Furthermore, because the qualified plan assets were not taxed during life, they can be taxed twice at your client's death: by income taxes in respect of a decedent (IRD taxes) and by estate taxes. In some cases, this double-whammy can erode the amount passed from your client to the heirs by as much as 70%. Additionally, unlike assets such as stock or real estate, qualified plan assets do not receive a "step-up" in basis at death.

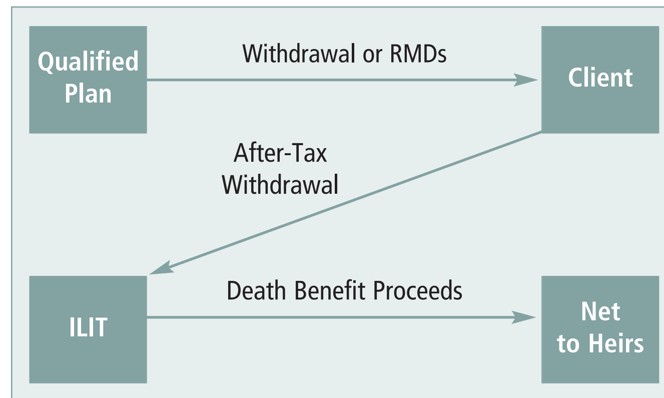
Fortunately, there is a way your clients can use their qualified plan assets to help increase the amount of money left to their heirs. It is called Qualified Plan Maximization (QPlan Maximization).

WHAT IS QPLAN MAXIMIZATION?

QPlan Maximization is a way for your clients to move assets from their qualified plan and use them to fund an Irrevocable Life Insurance Trust (ILIT). When properly drafted by the client's attorney to comply with the appropriate state laws, this ILIT can purchase life insurance on the client (and spouse, if desired) and potentially increase the amount of money left to the heirs.

HOW IT WORKS

First, your client takes a withdrawal from the qualified plan and pays income tax on this withdrawal. Then, the client's attorney drafts an ILIT, and the client makes a gift of the after-tax withdrawal to the ILIT. The ILIT will purchase a life insurance policy on the client, or on the client and spouse. If the trust is properly set up and administered, at the death of the clients the ILIT will receive the life insurance proceeds free of estate and income taxes and help to create a lasting legacy for the heirs.



CONSIDERATIONS

Annual Exclusion Gifts. An annual exclusion gift is the amount of annual gifts that each individual can make to an unlimited number of people without federal gift tax. Currently, this amount is $13,000 per individual per year, indexed annually for inflation and subject to specific qualifying rules. Your clients may be able to use their annual exclusion gifts to transfer the after-tax qualified plan withdrawal to the ILIT, free of gift taxes. When the ILIT uses this money to purchase life insurance, the amount of money to the heirs can be greatly increased.

Taking Withdrawals Before Age 59½. Clients who have not yet reached age 59½ will generally be subject to a 10% penalty tax on withdrawals that they take. The exception to this rule is if the client takes "substantially equal periodic payments" calculated annually based on the client's age and the IRS's life expectancy tables. Distributions that qualify as substantially equal periodic payments will not be subject to the penalty tax; however, once clients begin taking such payments, they must continue to take them every year.

Taking Withdrawals After Age 59½. Clients who have reached age 59½ may take withdrawals at their discretion without penalty and have a greater degree of flexibility. How much to withdraw generally depends on the size of the insurance need and the number of annual gift tax exclusions available to the client. Many clients chose to withdraw enough each year to match their available annual gift exclusions and pass that amount gift tax free to the ILIT. If there are enough annual exclusions available, the client can also increase the gift to the trust to match the after-tax RMDs that will be applied when the client reaches age 70½.

Repositioning RMDs. Clients who have already started taking RMDs may find that simply using the after-tax RMD to fund life insurance in an ILIT provides substantial leverage and can greatly increase the amount left to their heirs.

CASE STUDY: STEPHEN AND MARY HAINES

Stephen and Mary Haines (both 65, Preferred Non Smokers) have an overall estate of $5,000,000, including $1,000,000 in a traditional IRA that is growing at 5% a year. They have many other assets that provide them enough income to live on, including several rental properties. The Haines would like to leave the IRA intact for their three children; however, they know that they must start taking RMDs when Stephen reaches age 70½. They are also concerned about estate liquidity and do not want their children to have to sell the rental properties to pay estate taxes.

Their advisor recommends QPlan Maximization. The Haines will take annual withdrawals from their IRA (amount will increase over time to comply with RMD rules) and gift $30,000 in after-tax withdrawals to an ILIT. The ILIT will use this income stream to purchase a $2,750,195 John Hancock Protection SUL, a survivorship universal life insurance policy on Stephen and Mary's lives.[1] This approach not only increases the amount left to their heirs, but also provides liquidity so that other assets do not have to be sold to pay taxes.

As seen below, the total amount left to the heirs in year 28 will be $3,201,590 with planning, significantly more than the total amount left to heirs without planning.

EFFECTS OF PLANNING		
	DO NOTHING	WITH PLANNING
Qualified Plan Value in Year 28	$1,226,505	$957,320
Life Insurance Proceeds	$0	$2,750,195
Income Retained in Estate, growing at 3%	$1,790,411	$418,238
Estate Taxes on Qualified Plan and Sidefund	$1,600,967	$724,700
Income Taxes on Qualified Plan	$243,818	$199,463
Net to Heirs	$1,172,130	$3,201,590

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SUMMARY

Many successful clients find that once they've reached retirement their needs and concerns change. They find they have more than enough assets to live on, and are more concerned about making sure their heirs receive as large a legacy as possible. For these clients, QPlan Maximization can help reduce estate taxes, reduce IRD taxes and leverage withdrawals to create a lasting legacy for their heirs.

1. Based on Male and Female, both age 65, Non Smoker Preferred with annual level-pay premium of $30,000.

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