

Do Only Illiquid Estates Need Life Insurance?

By Robert J. Tonachio

Robert James & Associates, Inc.

A common misconception

People that are liquid assume that their financial holdings will be sufficient to pay off the estate taxes due nine months after their death, therefore life insurance has little to no value.

Let's look at both the liquid and illiquid:

The illiquid

Let's say a couple has \$20 million worth of real estate, is illiquid, and decides to purchase a life insurance policy to protect their estate. Both husband and wife are 60 years old, so approximately \$1,000,000 purchases a \$10,000,000 life insurance policy. Upon the death of this couple, the federal and state government assesses \$10,000,000 of taxes (death tax)* on their \$20,000,000 worth of real estate.

Due to the \$10,000,000 life insurance policy, their heirs will not have to seek a loan against the property or be forced to sell it for a fraction of its true value in order to pay the taxes due. Their heirs inherit the entire \$20,000,000 of real estate and only pay taxes on \$1,000,000, which was the premium on the \$10,000,000 life insurance policy. A win-win situation — the government gets the estate tax and the heirs get the full \$20,000,000.

The liquid

Now we'll look at a couple who has \$20,000,000 in liquid assets: CDs, Treasury Bills, municipal bonds, etc. They think they have enough liquidity to pay the taxes, so they decide not to purchase life insurance. They don't see a reason to pay \$1,000,000 for life insurance to protect their estate when it's already protected by their liquid assets.

When the liquid couple dies, the government assesses \$10,000,000 in estate taxes (death tax). The heirs have enough cash to pay the taxes, but are left with only \$10,000,000. This couple saved \$1,000,000 only to cost their family \$10,000,000.

Conclusion

The final result is that the illiquid couple left their family the full \$20,000,000, while the liquid couple left their family only \$10,000,000. The liquid couple could have easily moved \$1,000,000 from savings to pay for the single premium life insurance policy. The true expense would have only been the \$50,000 a year in interest that the \$1,000,000 would have earned before taxes. So, the liquid couple saves \$50,000 per year before taxes, only to lose \$10,000,000 tax free. Does this make sense? A win-lose situation — the government gets the estate tax and the heirs get \$10,000,000 less than they should have received.

**State inheritance and estate taxes may vary*