

# Money Matters

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## Skloff Financial Group Question of the Month

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**Q:** We read the Understanding Annuities and the Understanding Single Premium Immediate Annuities (SPIAs) articles. Can we increase our after-tax return on our safe money, guarantee that income for our lifetimes, gain coverage for a chronic illness or long term care, then transfer the safe money completely tax-free to our heirs?

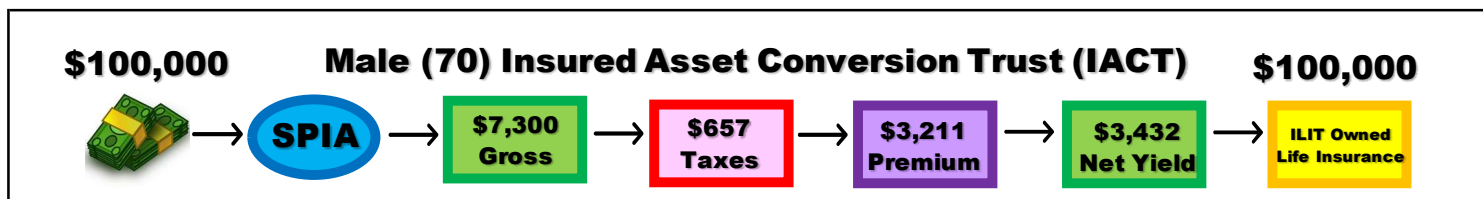
### The Problem – Increasing After-tax Returns with Guaranteed Lifetime Cash Flows, While Keeping the Asset for Heirs

There is a scarcity of guaranteed high interest rate vehicles. SPIAs offer high cash flows, but do not return the full principal to heirs.

### The Solution – Insured Asset Conversion Trusts (IACs)

The Insured Asset Conversion Trust (IAC) is a combination of a single premium immediate annuity (SPIA) and a life insurance policy. After the SPIA is funded, it provides a cashflow composed of principal and interest. **The percentage of cash flow that is principal is called the exclusion ratio, and is paid on a tax-free basis. The higher your age, the higher the exclusion ratio.** A portion of the after-tax cash flow then funds a life insurance policy. The life insurance benefit can equal the value of the SPIA (or can be even be higher) and can include a chronic illness or long term care benefit. Although the federal estate tax exemption is historically high, it is scheduled to drop after 2025 and have a **40% rate on nonexempt assets**. To protect the life insurance benefits from estate taxes, the life insurance policy can be owned by an irrevocable life insurance trust (ILIT), exempting the benefits from estate taxes. The IAC has four effects: 1) increased after-tax yields on safe money, 2) guaranteed lifetime cash flows, 3) coverage for a chronic illness or long term care and 4) transferring assets tax-free to heirs.

**Numbers Speak Louder Than Words.** Let's look at four scenarios for Bill (70) and Sue (70), who are in the 30% tax bracket and are evaluating where to place \$100,000 of their safe money. In scenario one, they could pay \$100,000 for a vehicle yielding **2.50% before taxes** and **1.75% after taxes**, or \$1,750 per year. When they die, the \$100,000 could be subject to a 40% estate tax, leaving \$60,000 for their heirs. In scenarios two, three and four, the life insurance is owned by an ILIT. In scenario two, Bill (70) could pay \$100,000 for a SPIA life with 10 year certain, yielding **7.30% before taxes** and **3.43% after taxes and life insurance premiums (4.90% pre-tax equivalent yield)**, or \$3,432 per year. In scenario three, Sue (70) could pay \$100,000 for a SPIA life with 10 year certain, yielding **6.80% before taxes** and **3.64% after taxes and life insurance premiums (5.20% pre-tax equivalent yield)**, or \$3,642 per year. In scenario three, Sue (70) and Bill (70) could pay a combined \$100,000 for a SPIA life with 10 year certain, yielding **6.30% before taxes** and **3.59% after taxes and life insurance premiums (5.14% pre-tax equivalent yield)**, or \$3,595 per year. See the image and chart below.



Traditional Asset vs Insured Asset Conversion Trust (IAC)				
	Original	70 Yr Old Male SPIA Life with 10 Yr Certain	70 Yr Old Female SPIA Life with 10 Yr Certain	70 Yr Old Female and Male SPIA Life with 10 Yr Certain
Value	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000
Yield Rate	2.50%	7.30%	6.80%	6.30%
Annual Income	\$ 2,500	\$ 7,300	\$ 6,800	\$ 6,300
Exclusion Ratio		70%	80%	75%
Taxable Portion	\$ 2,500	\$ 2,190	\$ 1,360	\$ 1,575
Tax Rate	30%	30%	30%	30%
Taxes	\$ 750	\$ 657	\$ 408	\$ 473
Net Income After Taxes	\$ 1,750	\$ 6,643	\$ 6,392	\$ 5,828
Life Insurance Premium to Replace Original Value		\$ 3,211	\$ 2,750	\$ 2,233
Net Income After Taxes & Life Insurance Premium		\$ 3,432	\$ 3,642	\$ 3,595
Net Yield After Taxes & Life Insurance Premium	1.75%	3.43%	3.64%	3.59%
Pre-Tax Equivalent Yield	2.50%	4.90%	5.20%	5.14%
Included In Estate	\$ 100,000	\$ 0	\$ 0	\$ 0
Estate Tax Rate	40%	40%	40%	40%
Estate Taxes	\$ 40,000	\$ 0	\$ 0	\$ 0
Net To Heirs	\$ 60,000	\$ 100,000	\$ 100,000	\$ 100,000

### Action Steps –Implement an IAC and Increase After-tax Returns with Guaranteed Lifetime Cash Flows and Keep Assets for Heirs

Increase your after-tax return on your safe money with a guaranteed lifetime cash flow, then a return of principal in the form of a tax-free life insurance benefit, using an IAC. Work closely with an experienced financial professional to understand and implement an IAC.

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