IRA/Qualified Plan Maximization

MetLife®

The main purpose of an IRA or qualified plan is to provide you with a stream of income throughout retirement. IRAs/qualified plans can also be an effective means of transferring wealth to future generations. If you plan properly, your IRA/qualified plan may be given a "second life" to provide for future generations.

Where will your IRA assets end up?

The First Obstacle to Passing on IRA/Qualified Plan Assets: Estate Taxes

If the total value of your IRA and other assets in your name, such as your home, investments, personal property and insurance exceeds $2 million – the Federal Estate Tax Applicable Exclusion Amount in 2006 – every dollar over $2 million can be taxed to your estate or beneficiary at rates up to 46%. *Estate taxes are due, in cash, within nine months of death. Will your beneficiaries find the liquidity to pay these taxes?*

In many cases, cash and other liquid assets are not readily available to pay the estate tax liability, requiring the beneficiary to withdraw all or a portion of the IRA. These distributions, however, trigger an income tax liability – thus, a double taxation. Estate and income taxes could consume up to 70% of the IRA/qualified plan's value when the IRA is passed to non-spouse beneficiaries.

Create a "Second Life" for Your IRA

With careful planning, however, you may be able to maximize income tax-deferral and extend the benefits of the IRA to the next generation. But first, you must create liquidity to pay for estate taxes.

One way to create liquidity is to purchase a life insurance policy. If you purchase a life insurance policy, your beneficiaries can use the life insurance death benefit to pay estate taxes. This way, beneficiaries will avoid having to liquidate the IRA/qualified plan assets to satisfy the estate tax bill. This strategy will help you effectively transfer your IRA to future generations.

An effective liquidity strategy works as follows:

- Once you reach the appropriate age, you can take out distributions from your IRA/qualified plan. Income taxes are due on these distributions.
- After-tax distributions from the IRA/qualified plan can be gifted to an irrevocable life insurance trust (ILIT).
- The trustee can purchase a life insurance policy on the life of the client (and the client's spouse if married) that will provide an income tax-free death benefit to the trust beneficiaries[1]
- The insurance proceeds will not be included in the client's taxable estate, and can offset the cost of estate taxes, thereby avoiding the unwanted liquidation of the IRA/qualified plan assets to satisfy the estate tax bill.

See how the Smiths created a "Second Life" for their IRA:

Phil and Joanne, ages 63 and 64, have two children (Brian and Jessica) and have saved $2 million in their company's qualified plan, which they rolled over to an IRA. They decided they had more than enough retirement income.

[1]The death benefit from life insurance is generally income tax-free, but consult your tax advisor about the income tax consequences when the life insurance death benefit is paid to an entity other than an individual.

Their concern was how they could pass the most assets on to their children, while keeping sufficient assets for a comfortable retirement.

They need some guidance:

Phil and Joanne discussed plans to gift the IRA to their children at their death. The family learned that the IRA could lose up to 70% of its value to estate and income taxes. What were Phil and Joanne's options? One thing they could do would be to use distributions from their IRA to purchase a life insurance policy, and use the death benefit to cover estate taxes due on the IRA. They would avoid having to liquidate their IRA to satisfy their estate tax bill.

This is how the strategy works:

- Phil and Joanne take distributions from their IRA. After paying taxes on these distributions, they can use the remaining money to purchase a life insurance policy, held in an Irrevocable Life Insurance Trust (ILIT).
- When they die, the life insurance death benefit will be paid to the trust, estate and income tax-free, for the benefit of the children.
- The children will use the death benefit to offset the cost of estate taxes.
- The children will be able to keep intact the full value of the IRA, and will inherit these assets.

They learned how to better utilize their IRA. The children, Brian and Jessica, will inherit assets equal to the full value of the IRA, unaffected by estate taxes. ■

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Loans or withdrawals will decrease the cash value and death benefit.

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