An educational guide for individuals and business owners

Guardian®

Distributing assets fairly and equitably

Inheritance equalization with life insurance can help

When creating your estate plan

...you may find you have assets that are illiquid or aren't easily divided among your heirs.

Perhaps you have a family business or valuable real estate that you want to keep in your family. Or a sizable property that can't easily be sold. There are many things you should consider when creating your estate plan, including how to distribute assets fairly among your children or heirs.

If you have a family business, it can be difficult to treat all your heirs equitably if you have one or more children involved in the business (i.e., your "participating" heirs), but others who are not (your "non-participating" heirs). This can be particularly troublesome if your business is your largest asset, and you want it to continue to the next generation.

There is one solution that can help: Using life insurance for inheritance equalization. In situations like these, life insurance can provide the liquidity to give all heirs their fair share of the estate — without liquidating any assets, including the family business.

We've designed this guide to help you learn more about inheritance equalization with life insurance.

How inheritance equalization with life insurance works

1. You (or the trust that you've created) purchase a life insurance policy on your own life.
2. When you pass away, the proceeds of your life insurance policy will provide a source of liquidity that can be used to "make up" the difference between the assets left to your non-participating heirs — and to those who are running (and will ultimately inherit) your business or other large asset.

Questions for you to consider

- When you pass away, do you want to leave your business and other illiquid assets intact for your heirs?
- Do you have assets (such as real estate, a vacation home or a family business) that may not be divisible without liquidation?
- Do you have some heirs who are more actively involved in your business than others?
- Do you want to prevent discord between heirs who are involved in the family business — and those who are not?
- Do you want another source of funds, other than the indivisible asset, to provide for your heirs who are not actively involved with that asset?

If you answered "yes" to some of these questions, you may wish to explore the advantages of inheritance equalization with life insurance.

Inheritance equalization with life insurance in action: A case study

Let's explore how an individual with four children was able to ensure that each of his children would receive an equal amount of assets at the time of his death.

Donald and Kathy Lockwood have four children — Gene, Jeff, Jennifer, and Arlene. Their current estate is valued at about $8.5M, and primarily consists of a business worth $4.5M and real estate of about $3M, with a smaller amount of stocks, bonds, life insurance, and other assets:

Business value	$4,500,000
Real estate	$3,000,000
Stocks and bonds	$1,000,000
Cash	$25,000
Existing life insurance	$25,000
Total	**$8,550,000**

The differing value of their various assets poses a problem for the Lockwoods. Their daughter Jennifer is the only child who is active in the business and they would like her to inherit it. Gene has been managing the real estate, so it would make sense to leave that to him. But if the Lockwoods take that approach, the results would be very unfair to Jeff and Arlene:

Heir	Inheritance	Amount
Gene	Real estate	$3,000,000
Jeff	Stocks and bonds	$1,000,000
Jennifer	Business	$4,500,000
Arlene	Cash and life insurance	$50,000
	Total	**$8,550,000**

Don and Kathy consult their Guardian Financial Professional, who suggests that Don purchase a $9,450,000 Guardian life insurance policy. The liquidity from this policy could then be used to equalize the inheritances between the children upon Don's death:

Heir	Inheritance	Amount	Life insurance	Total inheritance
Gene	Real estate	$3,000,000	$1,500,000	$4,500,000
Jeff	Stocks and bonds	$1,000,000	$3,500,000	$4,500,000
Jennifer	Business	$4,500,000	$0	$4,500,000
Arlene	Cash and life insurance	$50,000	$4,450,000	$4,500,000
	Total	**$8,550,000**	**$9,450,000**	**$18,000,000**

As the above chart illustrates, by using the inheritance equalization with life insurance approach, all the children in the family will receive the same amount of inheritance from their parents' estate.

The inheritance equalization with life insurance approach can help your clients and prospects divide their assets in a manner that they see as equitable, while helping to preserve the assets — and relationships of those left behind — for years to come.

Special considerations

Deciding how much life insurance to buy

Of course, only you can decide, but here are two common schools of thought:

An equal share

Some individuals feel that to be entirely fair, each child should receive an **equal amount** of assets. So, for instance, if there were three children, the estate were worth $6M and the family business was $4M of that, they would want each child to receive at least $4M, as the child who would get the business will acquire that amount.

- This approach results in the most money for the heirs, but also higher premiums, which may not be affordable: For example, in this case, this individual would have to purchase $6M of coverage to ensure all their children will have at least a $4M inheritance.

A "fair" share

Other people may want to make sure that their children get a **fair share** of the estate, but not necessarily the same amount. Using the above example, for instance, they would want to ensure that each child would get at least $2M, or $6M, divided by three.

Often, parents who are business owners feel that this is more equitable, as the child who inherits the business still has to run it and otherwise work for that money, while the children who receive the life insurance proceeds receive their cash outright.

- This approach is more affordable, as the individual would only need to purchase an additional $2M of life insurance to ensure that each child receives at least a $2M inheritance.

Deciding who should own the policy

The titling of your life insurance policy should be carefully considered before it is issued. Ownership affects control over the policy, protection from creditors (or lack thereof), and the tax treatment of the policy proceeds. The chart below outlines the pros and cons of policy ownership — whether the insured, his or her heirs, or a trust owns the policy.

If the insured owns the policy	If the heirs own the policy	If the trust owns the policy
Advantages: • The insured has complete control over the policy. • They also have access to policy values for supplemental income[1] or other needs. • There are no gift tax concerns related to premium payments. **Disadvantages:** • Depending on state law, the policy may be attachable by the insured's creditors.[2] • Policy is included in insured's estate for estate tax purposes.	**Advantages:** • Policy death benefit excluded from parent's estate for estate tax purposes. • Parent's creditors cannot attach the policy cash values. **Disadvantages:** • Unworkable if heir is a spendthrift. • Potentially a marital asset if the heir divorces. • Premiums paid by parent treated as a gift (although they may be eligible for the annual gift tax exclusion).	**Advantages:** • Policy death benefit excluded from parent's estate for estate tax purposes. • Through the terms of the trust, the parent can control when the proceeds are distributed to the heir. • Potential for professional trust management. • Offers very strong protection from creditors. **Disadvantage:** • Premiums paid by parent treated as a gift (although they may be eligible for the annual gift tax exclusion).

The advantages of inheritance equalization with life insurance

- **It's an equitable solution:** Your heirs can receive a more equal inheritance than they would have if the life insurance had not been purchased.
- **Potential tax savings:** Life insurance provides an income-tax free death benefit and the policy cash value grows tax deferred.[3,4]
- **Flexibility:** If you own the policy directly, you can access the policy values via loans/withdrawals[5] for supplemental retirement income or other needs.

Could inheritance equalization with life insurance be right for you?

Only you can decide. But once you've worked with your tax and legal advisors to choose this approach — and how you will implement it — a Guardian Financial Professional will work with you and your trusted advisors every step of the way to help facilitate the purchase of your coverage.

Contact a Guardian Financial Professional to learn more about the advantages of inheritance equalization with life insurance today.

[1] Supplemental income from a whole life policy comes from loans and withdrawals. Normally, cash values accumulate over the long term. Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income.

[2] State creditor protection for life insurance policies varies by state. Contact your state's insurance department or consult your legal advisor regarding your individual situation.

[3] Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[4] Some whole life policies do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial professional and refer to your individual whole life policy illustration for more information.

[5] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% tax penalty.

All scenarios and names mentioned herein are purely fictional and have been created solely for educational purposes. Any resemblance to existing situations, persons or fictional characters is coincidental. The information presented should not be used as the basis for any specific investment advice.

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