John Hancock
LIFE INSURANCE

Wealth Transfer Planning with Municipal Income

During these uncertain economic times, many investors have flocked to more conservative investments such as municipal bonds. What are municipal bonds? Municipal bonds or "munis" are bonds issued by a city or local government or their agencies. The unique feature of these bonds is that the interest income received by these bondholders is generally exempt from federal income tax and also from the income tax of the state in which they are issued.[1]

Muni investors may want to consider maximizing any unneeded income from these bonds by leveraging it with life insurance. In essence, this technique involves using a coupon bond to fund a "zero coupon asset" — life insurance. Let's take a look at the internal rate of return of this strategy at life expectancy.

Leveraging Municipal Bond Income

Our example involves a married couple, both age 65, Preferred Non Smoker, with two children who have accumulated significant wealth including an $8 million estate. Pensions and other retirement accounts pay their expenses. They have a municipal bond valued at $1 million, which is generating 4% income or $40,000 per year, which they are not reinvesting.

Let us assume this couple would like to maximize the amount of money they pass on to their heirs. They have decided to take a look at using this income to purchase a life insurance policy.[2] The unneeded income from the municipal bond can be used to purchase a policy on a single life or both spouses' lives. The life insurance can either be owned individually or by an Irrevocable Life Insurance Trust (ILIT) which would keep the policy proceeds outside of the taxable estate.[3] If a trust is going to own the policy, consider keeping the premium within the clients' annual gift tax exclusions so that they are not subject to gift tax.[4]

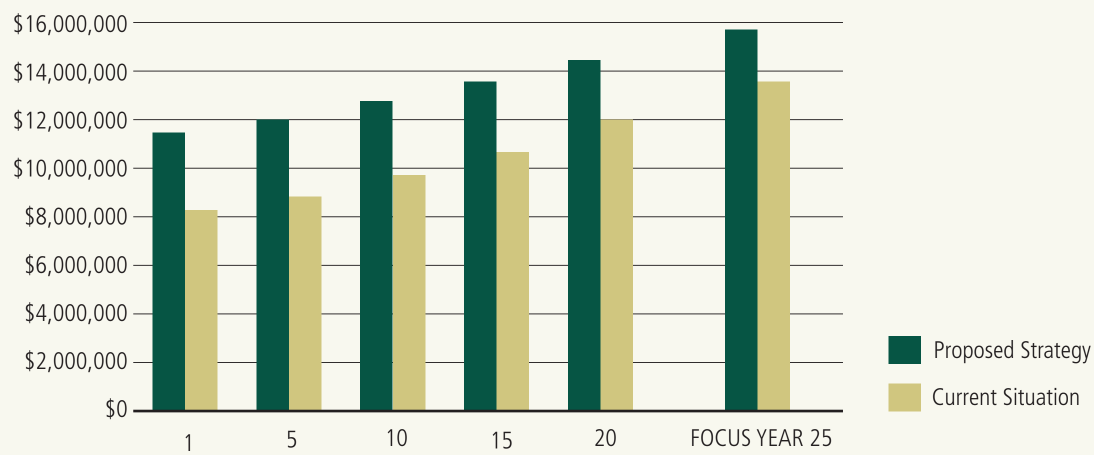
SUMMARY OF TAXATION AT DEATH

	Municipal Bonds	Life Insurance in the Estate	Life Insurance in an ILIT
Federal Estate Tax	Yes	Yes	No
Income Tax	No	No	No
Generation-Skipping Transfer Tax	Yes	Yes[5]	No[6]

In this situation, the couple can purchase a $3.3 million Protection SULG-09 policy with an annual premium of $40,000. Based on 2009 estate tax law, assuming the estate was growing at 3%, this proposed strategy would generate an extra $2.3 million at life expectancy (year 25) in net to heirs in contrast to just saving the income in the estate from the municipal bond, the current situation (see chart below). Also, the death benefit internal rate of return at this time would be 8.29%. So, in this case we have seen how ***leveraging the income from an unneeded asset is a win-win.***

IMPACT ON ESTATE IN YEAR 25

Net To Heirs



This is a supplemental illustration. Not all benefits and values are guaranteed. The assumptions on which the non-guaranteed elements are based are subject to change by the insurer. Actual results may be more or less favorable.

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1. Not all municipal bonds are exempt from federal and state income tax. Consult with tax advisors to determine the taxability of particular securities such as municipal bonds.
2. Municipal bonds and life insurance have different investment risks that need to be evaluated based on your specific situation. In some cases, depending on the type of insurance product used, the life insurance may be more risky when compared to your municipal bond holdings. Consult your tax advisor about your circumstances.
3. Trusts should be drafted by an attorney familiar with such matters in order to take into account income, gift, and estate tax laws (including generation-skipping transfer tax). Failure to do so could result in adverse tax treatment of trust proceeds.
4. Alternative funding methods are also available if gifts exceed allowable annual exclusions. Please consult your tax advisor.
5. The GST tax may apply to transfers of property to a skip generation beyond the transferor's available GSTT exemption amount. Skip persons include lineal descendants of the transferor such as the grandchildren and great grandchildren and so forth, as well as collateral relatives such as grand nieces and grand nephews, and an unrelated person who is 37½ or more years younger than the transferor.
6. If your available GST tax exemption is not sufficient to cover all of your lifetime gifts to the ILIT, the proceeds of the policy owned by the ILIT may be taxed for GST purposes, and GST tax will be due following certain transfers or distributions from the trust. GST exemptions should be allocated on a timely basis since the value of the gift is based on the date of the allocation rather than the date of the gift. Please consult your tax advisor.

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