

Advanced Matters

Monthly Advanced Marketing and Product Information from Transamerica



THE POWER OF IDEAS

*Featured strategy:
Life Insurance as an Asset Class*



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Transamerica's Advanced Marketing Department

Victor Sanchez
Director,
Advanced Marketing

Claire Durand, CFP®,
CLU, ChFC, CRPC, CASL
Advanced Marketing
Consultant,
Charitable Planning
Executive Benefits

Michael Gunnar, ChFC
Advanced Marketing
Consultant,
Retirement Planning

Nerre Shuriah, JD, LLM
Advanced Marketing
Consultant,
Estate Planning, Business
Succession Planning
Foreign Nationals

Andrea Valdez, JD
Advanced Marketing
Consultant,
Estate Planning
Premium Financing

Advanced Matters®

Nerre Shuriah, JD, LLM
Editor

Gay Groomes
Managing Editor

Jerome Tyler
Sr. Designer

Questions/Information
877-238-6758
AdvancedMatters@transamerica.com

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One lucky person with the right answer will win a prize.



Life Insurance as an Asset Class: Providing Comfort in Uncomfortable Times

By Victor Sanchez

As the title of this article indicates, we are living in “uncomfortable times.” Whether you have clients who are losing value in the stock market, losing their jobs or losing the value in their homes, it’s safe to say that people are looking for some sort of hope amidst the economic turmoil. Unfortunately, a life insurance carrier can’t fix the unemployment situation or reverse the housing decline. But Transamerica can provide some comfort to individuals who are looking for guarantees when it comes to their family’s future.

A New View

Of the many benefits afforded by life insurance, its most appealing characteristics revolve around two main tax advantages—income-tax free death benefits and tax-deferred growth. As a result of these attributes, life insurance is now being viewed in a new light—as an asset class. Assets can include items such as investments (stocks, bonds, mutual funds), real estate and retirement plans. However, these types of assets have the potential to fluctuate in value, which can create unease in individuals seeking to leave a legacy for their loved ones. Legacy planning has become more popular in recent years because of the uncertainty surrounding the estate tax repeal, as well as the realization that estate taxes are not the only reason wealth is lost



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June Featured Topic: Life Insurance as an Asset Class

Join us June 9th at 11 a.m.
(PDT) to discuss this topic and
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when it's transferred from one generation to the next. The increasing popularity of legacy planning, which heavily incorporates the benefits of life insurance, has further fostered the view of life insurance as an asset class. In fact, the following quote from the July 2007 issue of *Worth Magazine* helps encapsulate this view: "For those with a multi-generational view, insurance can be an attractive asset class when measured by the internal rate of return of the premium to the coverage amount—and when considering tax advantages, potential stability, predictability and noncorrelation to other investment alternatives."¹

Hypothetical Example

To further illustrate this point, let's look at a hypothetical example using Transamerica's guaranteed universal life insurance policy TransACE®. For our example, we'll assume our client is a female, age 70, standard nonsmoker, with a death benefit of \$855,000.

| Year | Net Death Benefit | Internal Rate of Return |
|------|-------------------|-------------------------|
| 10 | \$855,000 | 20.89% |
| 15 | \$855,000 | 9.28% |
| 20 | \$855,000 | 4.50% |

As this example shows, life insurance can provide an attractive internal rate of return (when compared to the premiums paid), which is considered valuable when measuring the success of any asset class—especially an asset that is positioned to be transferred to the next generation. With an internal rate of return of over 20% after 10 years, over 9% after 15 years and over 4% after 20 years—with no correlation to market performance—it's easy to see why wealthy families view life insurance

as an excellent asset class to include in their overall portfolio.² But life insurance has other desirable attributes that make it compelling when assessing potential assets to leave as a legacy.

Such advantages include:

- Liquidity (access to cash value while alive or proceeds that are immediately payable at death),
- Probate mitigation (proceeds can be kept out of the estate if ownership is structured correctly), and
- Estate equalization (proceeds can be easily divided at death to prevent conflict among family members).

¹"Untapped Potential," by Michael J. Brink and Thomas R. Love, *Worth*, July 2007.

²*Id.* (Nine in 10 family offices own life insurance and 59 percent anticipate adding additional coverage.)

Opportunity

This alternative view of life insurance provides an excellent opportunity for the life insurance professional to help wealthy families secure their legacy with an asset class that has a predictable and potentially guaranteed value. But what about the families who already own life insurance, either personally or through an irrevocable trust? Like any other portfolio or asset, periodic reviews are necessary to ensure that the asset still makes sense or is still appropriate for the client's goals at that particular point in time. A life insurance policy is no different.

“For those with a multi-generational view, insurance can be an attractive asset class when measured by the internal rate of return of the premium to the coverage amount—and when considering tax advantages, potential stability, predictability and noncorrelation to other investment alternatives.”

There are several different types of life insurance policies that serve many purposes. Consequently, some policies exist that do have correlation to market performance and have obviously suffered during this economic downturn, making a policy review even more imperative. This creates a tremendous opportunity for 1035 tax-free exchanges for policies that are personally owned or held in a trust. In fact, for those owned by a wealth transfer trust (a.k.a. ILIT), the trustee has a fiduciary responsibility to make sure that the policy owned by the trust is in the best interest of the beneficiaries of said trust. Surprisingly, less than 10 percent of life insurance agents are currently conducting policy reviews with their clients.³ What does this mean? This means that there are plenty of clients who need someone to make sure that their current policy still makes sense and, if it doesn't, to provide advice as to what policy would be more appropriate. This goes hand-in-hand with the fact that 50 percent of estate plans are over five years old.⁴ Older estate plans with older life insurance policies equal an opportunity for policy reviews and the potential for large 1035 tax-free exchanges.

³“The Policy Review: It's All about Advisor Credibility,” by Justin Jurs, *Life and Health Advisor*, January 2007.

⁴“Mythology of the Very Rich”, by Walter H. Zultowski, *Private Wealth Magazine*, December 2008/January 2009.

Conclusion

At the end of the day, life insurance is about protecting the future of loved ones and leaving a powerful legacy behind. While this fact is understood by life insurance agents and their clients, there are still those who “don’t believe in life insurance.” With this alternative view to life insurance—as an asset class—the argument for “why buy life insurance?” just got a little stronger!

Gain an advantage in the survivorship marketplace with TransACE Survivor[®] 2008

With its Assured Coverage Endorsement (ACE), TransACE Survivor 2008 remains committed to providing no-lapse, guaranteed protection, especially with level-and single-pay scenarios.

TransACE Survivor[®] 2008 \$1 Million Level Death Benefit/both Standard Nonsmoker

| Level Pay | | | | | |
|---------------------|------------------|---------------------|------------------|---------------------|------------------|
| Age 55 | | Age 65 | | Age 75 | |
| Transamerica | \$8,041 | Hartford | \$13,418 | Lincoln | \$23,885 |
| Pacific Life | \$8,123 | Transamerica | \$13,446 | Hartford | \$24,659 |
| MetLife | \$8,332 | ING Reliastar | \$13,899 | Transamerica | \$24,720 |
| ING Reliastar | \$8,353 | MetLife | \$14,129 | ING Reliastar | \$25,598 |
| Hartford | \$8,685 | Lincoln | \$14,340 | Sun | \$25,678 |
| Lincoln | \$8,687 | Sun | \$14,600 | MetLife | \$26,218 |
| Sun | \$8,877 | Pacific Life | \$14,693 | Pacific Life | \$27,917 |
| John Hancock | \$9,285 | John Hancock | \$15,968 | John Hancock | \$29,084 |
| Single Pay | | | | | |
| Age 55 | | Age 65 | | Age 75 | |
| Transamerica | \$140,508 | Transamerica | \$211,092 | Transamerica | \$323,683 |
| MetLife | \$147,711 | ING Reliastar | \$227,667 | Pacific Life | \$431,631 |
| ING Reliastar | \$150,335 | MetLife | \$231,599 | Hartford | \$341,799 |
| Hartford | \$156,797 | Sun | \$238,075 | ING Reliastar | \$350,018 |
| Lincoln | \$156,892 | Lincoln | \$239,557 | Lincoln | \$353,792 |
| Sun | \$158,533 | Pacific Life | \$252,922 | Sun | \$357,355 |
| Pacific Life | \$164,445 | John Hancock | \$253,916 | MetLife | \$370,692 |
| John Hancock | \$170,641 | Hartford | \$277,226 | John Hancock | \$383,071 |

This comparison is not a comprehensive analysis and does not account for possible advantages or disadvantages of the policies compared. Competitors' premiums have been obtained from publicly available sources and are believed to be accurate as of February 2009.

TransACE Survivor[®] 2008 is a nonparticipating, flexible premium universal life insurance policy issued by Transamerica Life Insurance Company, Cedar Rapids, IA 52499. Policy Form #1-12111108 (CVAT); Group Certificates #2-73436108 (CVAT) for certificates issued under a group policy issued to the Rhode Island National Consumer Protection Trust. Policy form and number may vary, and this policy may not be available in all jurisdictions.

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Finding Opportunities During Down Times: Roth IRA Conversions

By Michael Gunnar

Ask any world-class athlete about the keys to his/her success, and perseverance probably will be at the top of the list. One of the marks of greatness is one's response to tough times.

America has many clever sayings when it comes to dealing with difficult times:

"When the going gets tough, the tough get going."

"Every cloud has a silver lining."

"Tough times don't last; tough people do."

"When life gives you lemons, make lemonade."

At the risk of trivializing the financial pain we've been experiencing, are there opportunities to make lemonade out of some of the financial "lemons" the economy has been throwing our way? This article will be the first in a series devoted to the topic of finding opportunities in a down market.

Finding Opportunities in the Loss of Retirement Portfolios

One type of lemon many Americans have received in our current market environment is the loss of retirement savings. To some people, the bitter taste of negative returns means they'll have to postpone their retirement in order to recoup their investment losses. For others, it means they may have to cut back on their standard of living in retirement in order to make their retirement portfolio last longer. Still others will have to go back to work.

Roth IRA Conversion

There are a variety of factors to keep in mind when deciding whether or not to convert a traditional IRA to a Roth IRA. One of the more obvious factors has to do with tax planning. Individuals who convert their traditional IRA to a Roth IRA will pay taxes on the amount converted from the traditional to the Roth IRA.

Clients who have been considering converting their traditional IRA to a Roth IRA may discover that now is an ideal time to act, due to significant declines in the value of their IRA. If their IRA has turned into a "lemon," why not make lemonade by converting it to a Roth IRA?

Roth IRA Conversion Eligibility

Prior to 2010, taxpayers whose modified adjusted gross income (MAGI) is \$100,000 or less are eligible to convert their traditional IRA to a Roth. Beginning in 2010 the \$100,000 MAGI no longer applies.

Additionally, only the owner of the IRA, a surviving spouse beneficiary of a deceased traditional IRA owner or a spouse/former spouse in accordance with a separation or divorce agreement is eligible to convert to a Roth IRA. A nonspousal beneficiary of a traditional IRA may not convert an inherited traditional IRA to a Roth IRA. But, what is the benefit of conversion? Let's look at an example.

“There are opportunities to make lemonade out of some of the financial “lemons” the economy has been throwing our way.”

Roth IRA Conversion Example

In 2008, Randy (a 50-year-old male) had a traditional IRA worth \$500,000, none of which represented non-deductible (or after-tax) contributions. By May 2009, the value of Randy's IRA had declined to \$300,000. Consequently, Randy decides to convert his IRA to a Roth IRA. Randy will have to include the \$300,000 in his 2009 gross income. Assuming a federal income tax bracket of 28%, Randy would owe federal income taxes for the Roth IRA conversion in the amount of \$84,000. Let's further assume Randy does not take a withdrawal from his IRA to pay the income tax resulting from the conversion, but rather uses assets from other sources.

As long as Randy does not take distributions from his Roth IRA for five years and is at least 59½ years old, any withdrawals he does take from the Roth IRA will be income tax-free. Additionally, since the Roth IRA is not subject to minimum distribution requirements, Randy does not have to take any mandatory withdrawals from the Roth.

The following table will show what Randy's Roth IRA would have grown to over a period of 10, 15, 20 and 25 years compared to what the net after-tax amount of a Traditional IRA would have grown to had he not converted to a Roth IRA. The figures take into account the following assumptions:

- No withdrawals are taken from either IRA account
- Because an extra \$84,000 was used to pay the income taxes under the Roth IRA conversion scenario, an additional \$84,000 will be taken into account when looking at the non-Roth IRA conversion results. The \$84,000 will be assumed to grow in a taxable account and taxed annually at the federal income tax rate of 28%.

| With a Roth IRA Conversion | | | Without a Roth IRA Conversion | | |
|----------------------------|------------|------------------|---|--|--|
| Assumed Interest Rate | # of Years | Roth IRA Balance | Traditional IRA Balance (after federal income taxes at 28%) | Growth of additional \$84,000 from other assets (annual earnings taxed at 28%) | Combined total of after-tax value of IRA and after-tax growth of additional \$84,000 |
| 8% | 10 | \$ 647,677 | \$ 466,327 | \$155,530 | \$ 621,857 |
| 8% | 15 | \$ 951,650 | \$ 685,188 | \$205,789 | \$ 890,977 |
| 8% | 20 | \$1,398,287 | \$1,006,766 | \$272,289 | \$1,279,055 |
| 8% | 25 | \$2,054,543 | \$1,479,271 | \$360,277 | \$1,839,548 |

Role of Life Insurance in Roth IRA Conversions

If a Roth IRA conversion is one way to help clients turn their financial lemons into lemonade, then perhaps adding life insurance to this strategy will make the lemonade even sweeter!

Let's go back to our example with Randy. Perhaps he has enough assets outside of the Roth IRA and would like to set up a stretch IRA strategy to provide a source of tax-free income for his children. Because Randy is still the owner of the Roth IRA, it will be included in his estate upon his death and subject to any estate taxes. In order to help his children pay the estate taxes due attributable to the Roth IRA, Randy could establish an irrevocable life insurance trust (ILIT) to own and pay premiums on a life insurance policy insuring Randy's life.

The benefit of this would be that his children would not have to withdraw money from the Roth IRA to help pay estate taxes. The ability to keep more assets in the Roth IRA will allow Randy's children to grow more of their assets on a tax-deferred basis. Additionally, the more assets Randy's children can keep in the Roth IRA, the more tax-free income they will receive throughout their lifetime!



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Transamerica has packed valuable strategies into a 15-minute, monthly conference call series. It's a great time to sell life insurance, so listen and learn how you can capture more opportunities in 2009.

Calls take place the second Tuesday of the month, 11:00 to 11:15 a.m. (PDT). Call-in numbers: U.S. (888) 428-4472; International (651) 291-0900.

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| Business Succession Planning | 7/14/09 |
| Guarantees in Retirement | 8/11/09 |
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| Blended Families | 10/13/09 |
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News Item: A Cautionary Word on Donor-Advised Funds

By Claire Durand

Advisors often recommend donor-advised funds (DAFs) to charitably inclined individuals because of their low cost and flexibility. A DAF is owned and operated by a charitable organization, which provides grants based on the recommendations of the donor. In return for the irrevocable gift, the donor receives a charitable deduction similar to if the asset was gifted directly to a public charity.

A DAF can be a great alternative to creating a private foundation because it can be easy to establish with low administrative expenses and subject to fewer regulations, restrictions or exposure to excise taxes. The DAF can be a donor's sole charitable planning strategy, or it could be used in conjunction with other planning strategies such as acting as the charitable beneficiary for charitable remainder trusts (CRTs), charitable lead trusts (CLTs) or Enhanced Charitable Trusts (ECLATs). If a donor gifts appreciated property to a DAF, there is a double tax savings of a charitable deduction and avoidance of capital gains taxes when the asset is sold. Through a donor-advised fund agreement, donors enjoy advisory status over the funds that they have gifted to the DAF. The DAF makes grants to charities based on the donor's recommendations; however, it is not legally bound to do so.

Herein may lie a problem. In a recent case, *Ray Styles v. Friends of Fiji*¹, the donor sued a DAF for not following his recommendations to distribute his gifted funds to charitable organizations. The donor, Ray Styles, made a \$2.5 million charitable donation to Friends of Fiji, a DAF which ultimately ignored his recommendations. The DAF used the donor's funds to pay the high salaries of the DAF's officers, fund expensive celebrity golf events and, even worse, to pay legal fees against the donor in the court case which followed. This past February, Ray Styles filed an appeal with the Nevada Supreme Court because—although the Nevada District Court held that the charity breached the terms of the DAF agreement and its duty of good faith and fair dealing—Mr. Styles was not awarded any remedy or damages.

Unlike the control afforded to individuals who set up private foundations, the charity is deemed to have ultimate authority, control and discretion over a donor's contribution to a DAF. The important lesson here is due diligence. Information on the financial status, history, nature, fees, performance and even past experience of its current donors can help clients make the right decision when making the decision to gift assets to a donor-advised fund.

¹*Ray Styles v. Friends of Fiji, A Nevada Corporation*; Gary Nerison, James S. Bickel, District Court, Clark County, Nevada, No. 51642.

LIFE INSURANCE PLANNING PITFALLS: Stay Away from These Common Mistakes!



There are several ways in which the decisions about a life insurance policy can result in adverse tax consequences. In this series of Planning Pitfalls, we'll point out common errors that we see in life insurance and retirement planning and help you avoid them.

The Problem

In making a gift of a life insurance policy, the donor usually wants to use his or her annual exclusions to avoid or minimize any gift tax.

The Pitfall

Mr. Green owns a whole life insurance policy on his own life, with a cash value of \$78,000. Mr. Green wants to gift the policy to his three children to remove the proceeds from his estate for the benefit of his children. Mr. Green splits the gift with his spouse, Mrs. Green, in the hopes of sheltering the transfer under the available annual exclusions and thereby avoiding any gift taxation.* The transfer is set up so that their children will own the policy jointly with rights of survivorship.

Upon audit, Mr. Green is horrified to learn that the transfer does not qualify as an annual exclusion gift. Whenever joint action is required to exercise ownership rights, the policy is a gift of a future interest and will not qualify as an annual exclusion gift.

The Strategy

In order to rectify Mr. Green's situation to the extent available, the unified credit may be reduced to offset the tax liability on the transfer of the policy to his children. Mr. Green should have either a) had his children own the policy as tenants-in-common or b) transferred the policy to an irrevocable life insurance trust (ILIT) that contains Crummey withdrawal provisions. An ILIT may be the better of the two alternatives because an interest in property owned as tenants-in-common may be transferred at will by any co-tenant to anyone, at any time.

**The annual gift tax exclusion amount for 2009 is \$13,000. Split gifts of \$26,000 each to three children will total \$78,000.*

TRIVIA CONTEST

Which one of these activities was *not* recently listed on the IRS's Top 10 Tax Scams for 2009?

- A. Phishing**
- B. Disguised Corporate Ownership**
- C. Frivolous Income**
- D. Hiding Income Offshore**

If you know the answer to our trivia question, please send an email to AdvancedMatters@Transamerica.com. Please put your answer (either A, B, C or D) in the subject line of the email and put your address in the body of the message. One lucky person with the correct answer will receive a prize.



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