

McDaniel-Knutson

FINANCIAL PARTNERS

Life Insurance:

Should You Sell or Surrender your Policy?

Associates:

Wayne L. McDaniel
CLU, ChFC, CFP®

Jude McDaniel
CLU, ChFC

Peter D. Knutson
CFP®, CLTC

Victoria M. Bogner
CFP®

Ed Zeller
ChFC, CFP®

Staff:
Tammy Barnes

Karey Chester

Cindy Folks

Jennifer Gaupp

Keith Gilliland

Kara Gourley

John Phythyon

2500 West 31st Street,
Suite B
Lawrence, Kansas 66047

Phone (785) 841-4664
Fax (785) 841-7719
www.mcdanielfinancial.com

What do you do when you no longer need an existing life insurance policy? Most owners simply surrender it for the cash value if it has one (most permanent-type life insurance policies do; term insurance policies generally don't).

Some life insurance policyholders sell them and receive more cash than they would have if they'd simply surrendered them. Why would anyone purchase someone else's life insurance policy? Buyers look at it as an investment, since the policyholder will die some day, thereby delivering a death benefit to the buyer.

What are the tax consequences then for surrendering or selling a life insurance policy? The IRS examined three situations to help determine the tax results.

Situation 1: A man purchases a permanent life insurance policy and names his wife as beneficiary. Twenty-five years later, she passes away, and he decides there is no longer a need for the policy. So he surrenders it and collects the cash value of \$75,000. At the date of surrender, he had paid \$50,000 in premiums; \$10,000 of which was the

cost of the insurance protection as of the surrender date. Since a 1964 IRS ruling determined any proceeds from surrendering insurance in excess of the total premiums paid are ordinary income, the man would have to declare \$25,000 of income from surrendering the policy on his tax return.

Situation 2: Same facts as Situation 1 except the man sold the policy for \$85,000 to an unrelated buyer. In this case, the man must calculate his adjusted basis in the

insurance contract, which is done by subtracting the insurance's cost (\$10,000) from the total premiums paid (\$50,000). That makes the adjusted basis \$40,000, so the overall gain is \$45,000 ($85,000 - 40,000 = 45,000$).

The IRS taxes this money in two ways. The amount of the profit that would have been collected had the policy been surrendered is taxed as ordinary income (\$25,000 in this case; see Situation 1 above). The rest (\$20,000 in this example) is treated as a capital

(continued on page 2)



Life Insurance: Should You Surrender or Sell your Policy? *(continued from page 1)*

gain. Capital gains taxes currently max out at 15% – much less than the tax rates on ordinary income (which can be as high as 35%).

Situation 3: Instead of a permanent policy, the man buys a 30-year term one with no cash-surrender value. He pays \$25,000 in premiums up to the date he sells it to an unrelated buyer for \$20,000. Like in Situation 2, he has to figure the adjusted basis to determine his tax liability. In this example, the cost of the insurance is \$25,000, so the cost minus the premiums paid equals \$0 in terms of ordinary income. The \$20,000 from the sale is therefore treated entirely as a capital gain.

It's important to note that, if the insured is terminally ill (doctors expect him or her to die within a year) and sells the life policy to a viatical settlement company, any gains are tax-free. If the policy has an accelerated death benefit clause, funds can be withdrawn from it according to the contract, and they are also tax-free. In this scenario, the insured and his or her beneficiary will generally receive more money tax-free by keeping the policy until death and using its accelerated death benefit feature than by selling it.

~Edward K. Zeller, ChFC, CFP®

Increasing Potential Retirement Income with SPIAs

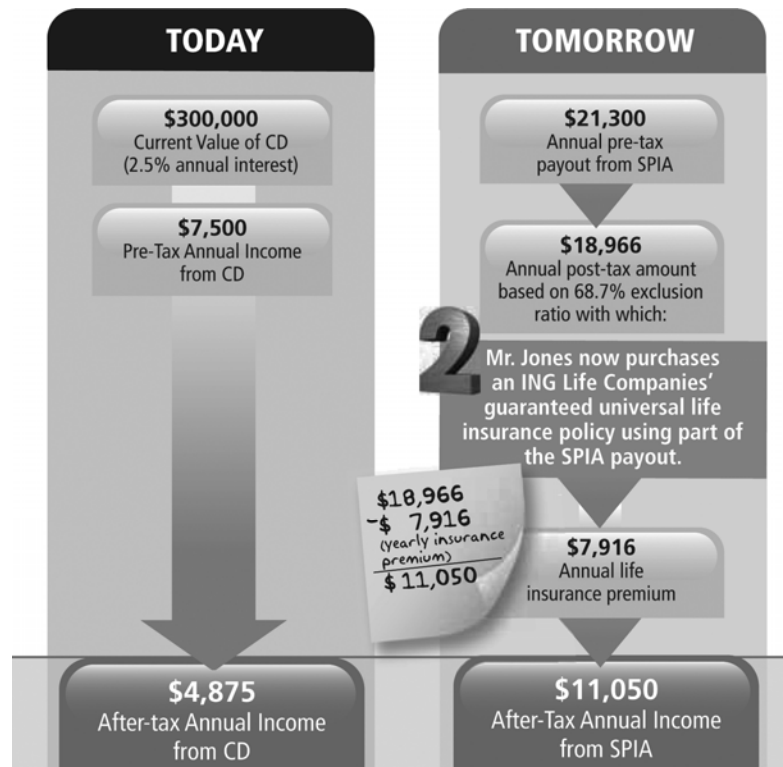
Converting your savings into retirement revenue is a major goal in most investment strategies. But no matter how much you've saved, it may still be possible to make what you have do more for you. A Single Premium Immediate Annuity (SPIA) may be one way to have your funds do more once you've retired.

Consider the following example: Mr. Jones is a 65-year-old retiree, who is a non-smoker in good health. His marginal tax bracket is 35%, and he has a \$300,000 CD. He uses the income from the CD as revenue and intends to leave its principal to his grandchildren after he dies.

The CD is earning 2.5% annual interest, which amounts to \$4,875 in after-tax income. However, if Mr. Jones were to cash out the CD when it matures instead of renewing it and instead invest that \$300,000 in an SPIA, he could potentially increase his after-tax income considerably. The annual after-tax payout would be \$18,966. Mr. Jones then uses a portion of that money to purchase a guaranteed universal life insurance policy for an annual premium of \$7,916. That leaves \$11,050 in annual net income from the SPIA.

In this scenario, Mr. Jones increases his annual income from this investment by \$6,145 by converting the CD to an SPIA, and he still has a \$300,000 legacy to leave to his grandchildren in a tax-free death benefit.

Naturally, market fluctuations may change the rates of



return, and it's important to note that the life insurance policy and the SPIA have surrender charges associated with them a CD does not, which could decrease their value. To find out if an SPIA is right for you, contact us.

~Wayne McDaniel, CFP®, CLU, ChFC

Market Commentary

Greed, Fear, and the Market: Is It Time to

Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it.

—Warren Buffet

It's been a year of high volatility and low overall returns in 2011. At the time this article was written (June 18), the Dow Jones Industrial Average had just experienced its longest losing streak since 2002 — six down weeks in a row. The global economy is in crisis, and the US recovery is slowing. Is now a good time to invest?

Psychologically speaking, two things drive investor decisions: greed and fear. The former causes one to buy when news is rosy and everything seems to be going up without signs of stopping. These points in time usually correspond with market tops. Fear, on the other hand, causes one to sell when news is in the dumps and it looks like the end of the world as we know it. This usually occurs during market bottoms.

These are emotional reactions, which is precisely the wrong way to invest. “Buy high, sell low” is the inevitable result, which is devastating to performance. Everyone knows to buy low and sell high — but the reality is that is very hard to hang on when the news is bad and even harder to buy at those times.

This is where we are today. Greece is unraveling, politicians are wrangling over the debt ceiling, unemployment is not improving, housing is still in the tank, and another recession may be coming. This sounds remarkably like last summer.

Let's look at some things objectively. Corporate earnings are near their pre-market highs, and most companies are affirming positive guidance. Interest rates are still low, and there is no indication the Federal Reserve is going to raise interest rates any time soon. Government tax revenues are up more than expected. Retail sales have been strong — the consumer is still spending money!

Markets and investor sentiment naturally cycle between greed and fear extremes, even during bull markets. In spite of all the recent headlines, things are not as bad as they sound. Yes, the bull market will come to an end, but there are compelling reasons to believe this is not it yet. Rather, this is more likely a pullback within the context of a bull. As such, this is not a time to panic, but rather a time to re-evaluate and buy while prices are lower.

Remember that every pullback in the midst of a bull market is a buying opportunity, and only the very last pullback is the one that leads to a new bear market. Most investors treat each pullback as the potential “big one,” although there are several pullbacks in a bull market before a new bear forms.

We do believe there is another shoe to drop in this global economy and that we are still in a “Secular Bear Market,” which is a long-term bearish cycle (this one started in 2002), and that it will continue for several more years. We recognize there are severe fiscal and economic problems. But, until we see some weakening in corporate profits, the evaporation of “buying pressure,” and internal weakening in “market breadth,” and other classic signs of a bear market, we believe this dip is an opportunity to buy, not a reason to sell.

~Wayne McDaniel, CFP®, ChFC & Victoria Bogner, CFP®



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2500 West 31st Street, Suite B
Lawrence, KS 66047-3051

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Eyes on the Future – Advisor Spotlight on Ed Zeller

Ask Ed Zeller what his hobbies are, and he'll tell you they all center around his kids now. He enjoys puzzles and attending Kansas City Chiefs games, but it is his three children and their activities that consume the majority of his free time.

That's no surprise given Ed's interest in youth. He realized in college that numerous adults in the community were responsible for guiding him in the right direction. Coming from a small-town, large family, in which he was the only one to go to college, the push to do more with his life came from his best friend, coaches, and teachers.

It was how the community helped and supported him that inspired Ed to believe he too could make a difference in the lives of the next generation. He now aspires to be a positive role model for young people, and he involves himself in organizations dedicated to improving the lives of children and young adults.



He is a member of Civitan, an organization dedicated to assisting the mentally and physically challenged, especially youths.

He is a member of the youth-oriented Optimist Club, which provides financial support for local youth programs, college scholarships for high school seniors, and oratorical and essay-writing contests for fourth through twelfth-graders, among other activities.

Since coming to Lawrence, he has maintained his memberships in the Topeka Civitan and Optimist Clubs, while joining the Lawrence chapter of the breakfast Optimists. (Lawrence doesn't have a Civitan group).

The group's commitment to providing solid, adult role models and financial assistance for young people while maintaining a positive mental attitude is a perfect fit for Ed. Quiet, unassuming, and always positive, he is passionate about improving the lives of the next generation. His eyes are always on the future – whether with his own children at home, or the many he benefits as a volunteer.