ESTATE EQUALIZATION:

Ensuring a Fair Inheritance for All Heirs

Every parent who has more than one child knows how challenging it can be to treat all their children fairly. It is particularly challenging for your clients who have assets which will be difficult to divide equally without liquidating them, such as a family business or real estate. This problem can be complicated when some of the children have been active in that business and others haven't. How can your clients treat all of their heirs fairly, while still preserving the assets they worked so hard to build? Life insurance can help.

Life insurance can provide a pool of liquid assets at your client's death which can be used to make sure all the heirs receive a proper inheritance. There are two primary ways of calculating how much life insurance is needed: an "equal share" approach and an "equal amounts" approach.

Equal Share Approach

Under the equal share approach, the total projected estate is divided by the number of children to determine the minimum share that each child will receive. Then, life insurance is purchased to make sure each child receives at least that minimum amount. This approach is particularly appropriate when one of the illiquid assets in question is a family business in which one of the children works. Since the success of the business is also driven by the efforts of that child, it is fair that child receives a larger total inheritance. Let's look at an example.

Johnny and Lily Eames (Male, Age 58, Preferred Non Smoker and Female, Age 57, Preferred Non Smoker,) have three children, John Jr., Kathy and Robert. John Jr. is a director in the family business valued at $2.5M, while Kathy and Robert help manage some rental real-estate properties valued at $1.5M. Johnny and Lily also have about $1M in stocks and bonds. They plan to leave the business to John Jr. and split the remaining assets between Kathy and Robert. Assuming the business and stocks grow at 4%, and the real estate grows at 3%, in 10 years the total estate would be worth about $6.4M. John Jr. would have an inheritance of $3.7M while Kathy and Robert would each get only $1.3M — or $770,000 *less* than they would receive if their parents liquidated the entire estate and split it into equal shares.

Johnny and Lily decide to purchase a $1.5M Protection SUL life insurance policy with a premium of $11,388. The extra liquidity provided by the death benefit will be split between Kathy and Robert, so they are both projected to receive at least $2M. While John Jr. will still potentially receive more, Johnny and Lily believe this is a fair result based on John Jr.'s hard work in driving the success of the business.

Comparison of Values in Year 10						
	Current Projected Inheritance Allocations			Proposed Projected Inheritance Allocations		
Asset Type	John Jr.	Kathy	Robert	John Jr.	Kathy	Robert
Business Assets	$3,700,611	$0	$0	$3,700,611	$0	$0
Real Estate	$0	$1,007,938	$1,007,938	$0	$1,007,938	$1,007,938
Stocks and Bonds	$0	$370,061	$370,061	$0	$370,061	$370,061
Cash	$0	$0	$0	$0	$0	$0
Life Insurance	$0	$0	$0	$0	$774,204	$774,204
Total Inheritance in Year 10	$3,700,611	$1,377,999	$1,377,999	$3,700,611	$2,152,203	$2,152,203

The data shown is taken from a hypothetical calculation. It assumes a hypothetical rate of return and may not be used to project or predict investment results.

Equal Amounts Approach

Under the equal amounts approach, the values in the estate are projected forward and the illiquid assets are passed to each of the respective children. Then, enough life insurance is purchased to make sure that the child inheriting an asset of lesser value receives enough death benefit to make up the difference. This approach requires more life insurance than the fair shares approach, and it is important to make sure your client will financially qualify for and be able to afford all the life insurance purchased. This approach works best when the estate contains illiquid assets that are not tied to the efforts of any of the children.

Justine McKenzie (Female, Age 62, Preferred Non Smoker) has a relatively small estate. She owns a three-family house in Belmont, Massachusetts, worth about $500,000. She lives on one of the floors, and rents the other two out to tenants. She also owns a small vacation house on Cape Cod, worth about $250,000, which she rents out when she is not using it. Between her pension plan, Social Security and the income from the rental properties, she has enough money to live quite comfortably. Justine is concerned about how to divide her assets between her two daughters, Julie and Kate. Julie works in Boston and has always loved the Belmont house, while Kate often uses the Cape Cod home for vacations with her husband and children. But if Justine leaves each daughter her favorite house, Kate will receive less than Julie does. Assuming a growth rate of 3% for both houses, in year 10 the Belmont house will be worth around $671K, while the Cape house will only be worth $335K.

Justine decides to purchase a $335,000 Protection UL policy with a premium $5,484. When added to the value of the Cape house, it creates a potential inheritance of $671K for Kate, the same amount of inheritance projected for Julie.

JH Solutions Software Can Help

John Hancock's latest JH Solutions software module, Estate Equalization, can demonstrate these techniques and how they might apply to your clients' situations.

To request an illustration or get a copy of the sample output for these cases, call your John Hancock representative or the Advanced Markets department at 888-266-7498, Option 3.

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