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43

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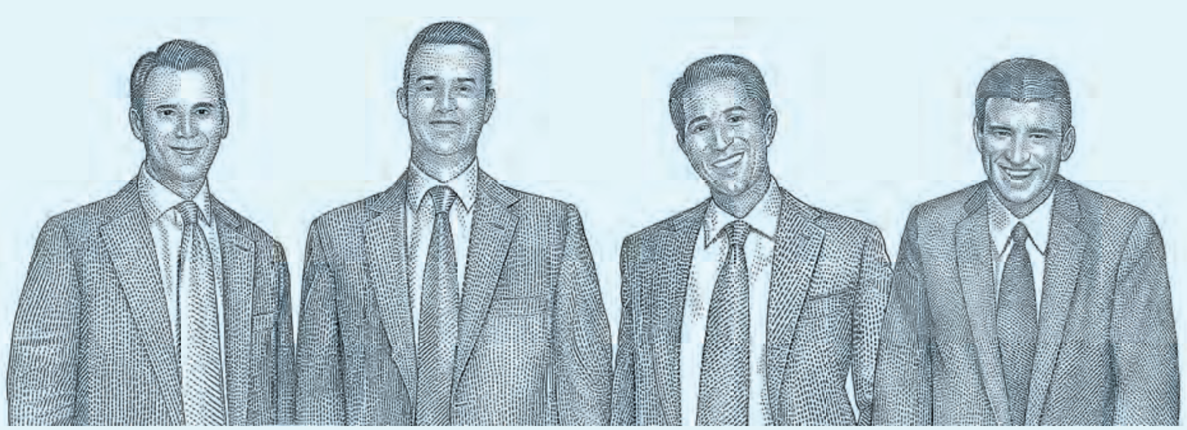
How can leverage be strategically used to protect your estate?

BY STEPHEN A. SCHWARTZ, CFP®, AEP®



Left to right:
Kevin R. Luchetta,
Paul D. Tortorella,
Stephen A. Schwartz
James L. DiNardo

PIONEER FINANCIAL AT NORTHWESTERN MUTUAL – PARK AVENUE | 245 Park Avenue, Suite 1800, New York, NY 10167 | 646.459.6366

TEAM
Kevin R. Luchetta, CFP®, AEP®, Partner
Stephen A. Schwartz, CFP®, AEP®, Partner
James L. DiNardo, CLU®, ChFC®, CFP®, MSFS®, Partner
Paul D. Tortorella, Partner

FINANCIAL SERVICES EXPERIENCE
Kevin R. Luchetta, 19 years
Stephen A. Schwartz, 16 years
James L. DiNardo, 16 years

ASSETS UNDER MANAGEMENT
$1+ billion

COMPENSATION METHOD
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Financial planning, investment advisory, risk management and money management services

MINIMUM FEE FOR INITIAL MEETING
None required

MINIMUM NET WORTH REQUIREMENT
$1 million

EMAIL
kevin.luchetta@nm.com
stephen.schwartz@nm.com
james.dinardo@nm.com

WEBSITE
www.pioneer.financial

ILLUSTRATION BY KEVIN SPROULS

Life insurance can be an essential estate-planning tool for wealthy individuals and their families. In fact, for those who lack liquidity, a properly designed and funded life insurance policy can be an efficient way to generate enhanced cash flow to cover future estate-tax obligations.

Illiquid assets come in a variety of forms. They include: real estate; tax-deferred retirement assets; business or partnership interests; private equity and hedge fund investments; art and jewelry collections; and luxury vehicles, including marine vessels, private aircraft, etc.

Life insurance proceeds may circumvent the need for premature, unfavorable or otherwise untimely sales or withdrawals of assets by heirs. To ensure that the death benefit avoids estate taxes, policies may be held in an irrevocable life insurance trust (ILIT).

Permanent life insurance policies typically require sizable premium payments, and finding liquid assets to fund the payment is not always a simple matter. Therein lies a core estate-planning challenge: If a trust owns the policy, technically it is the trustee that must pay the policy premiums on an ongoing basis.

The insured may make gifts to the trust to cover the premiums. The insured must, however, be mindful of annual gift tax exclusions and lifetime exemptions, which may or may not permit donors to transfer assets to cover the entire premium tax-free.

One solution to this planning dilemma is the use of premium financing to fund the premiums on a life insurance policy. In the case of an ILIT, the trustee will borrow money from a third-party lender to pay the premiums. The loan will not be considered a gift to the trust and will not create a gift-tax obligation. Loan interest may be considered a gift depending on how it is paid. Interest payments are, however, remarkably lower in the early stages of a loan compared to the scheduled premium. This reduced outlay may create the opportunity for gift-tax leverage and increased long-term internal rate of return (IRR).

Premium financing is at times a viable alternative for high net worth individuals. With proper structuring, it offers possible gift and estate-tax benefits. Additionally, the use of leverage allows investors to retain capital in long-term or higher-yielding investment strategies; and at times it also helps them avoid taxes on liquidated assets used to pay premiums.

When entering into a premium financing arrangement, you will be wise to have a definitive plan on when and how the loan will be repaid. If your intent is to use the cash value or death benefit from the policy to retire the loan, the policy should be carefully monitored to ensure that it is performing as projected. A contingency plan should always be developed, which may involve planned liquidation of other assets to repay the loan.

Like using borrowed funds for financing real estate or the expansion of a business, utilizing leverage to fund life insurance should dovetail with one's financial plan. It is essential to evaluate how premium financing may fit within the context of the client's overall estate plan, as well as to weigh the potential benefits against relevant risks. ●

> "Premium financing is at times a viable alternative for high net worth individuals."

ABOUT US

PIONEER FINANCIAL AT NORTHWESTERN MUTUAL PROVIDES FINANCIAL SERVICES TO HIGH NET WORTH AND EMERGING HIGH NET WORTH INDIVIDUALS, FAMILIES AND BUSINESS ENTERPRISES. Pioneer Financial's team of 20 associates/staff serve clients nationwide from their Park Avenue office in New York City. Kevin R. Luchetta, Stephen A. Schwartz and James L. DiNardo are wealth-management advisors and CERTIFIED FINANCIAL PLANNER™ practitioners. The practice is focused on assisting clients through comprehensive financial planning that includes asset management, retirement funding, risk management, estate preservation and distribution. ●

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Kevin R. Luchetta, CFP®, AEP®
Partner

Stephen A. Schwartz, CFP®, AEP®
Partner

James L. DiNardo, CLU®, ChFC®, CFP®, MSFS®
Partner

Paul D. Tortorella
Partner

Pioneer Financial at Northwestern Mutual – Park Avenue
245 Park Avenue, Suite 1800
New York, NY 10167
Tel. 646.459.6366

kevin.luchetta@nm.com
stephen.schwartz@nm.com
james.dinardo@nm.com
www.pioneer.financial

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