

## ***Life Insurance: The Impact of Ownership***

*The major reason most consumers buy life insurance is to provide financial support to beneficiaries in case the insured person dies prematurely. However, there are additional reasons why life insurance is purchased—to pay off debt or the balance on a home mortgage upon death, for funeral expenses, for children's college education, and for investment and estate planning.*

*Knowing who owns a life insurance policy, who the policy covers, and who stands to benefit in the event of death are all important considerations, but it can also get confusing. At the end of this fact sheet you will find a short glossary designed to help you understand terms related to ownership of life insurance.*

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### **WHO IS THE OWNER?**

The policy owner is the person named in the insurance contract who has control of the policy. Usually, this is the person whose life is insured. Or a beneficiary, such as the spouse, could be the owner. In other cases, neither of these parties is the owner. This often occurs when a business buys insurance on its partners to cover the value of the insured's share of assets in the company.

The policy owner has certain important rights to the policy, including:

- ◆ paying the premium;
- ◆ naming beneficiaries;
- ◆ determining the various options within the life insurance policy, such as settlement options;
- ◆ changing owners of the policy in the future;
- ◆ borrowing from a cash buildup in the policy; and
- ◆ changing any other feature in the insurance policy.

### **WHY IS OWNERSHIP IMPORTANT?**

As previously mentioned, you do not have to be the owner of a life insurance policy covering your own life. The policyholder could be another person, such as a spouse or other relative, or a trust. Ownership has greater impact when major life events, such as divorce or death, occur.

Upon the death of the insured, beneficiaries owe no income tax on insurance proceeds. The proceeds will be included in the owner's estate if the owner and the insured are the same person, regardless of who is the beneficiary. In this case, the owner's estate could be responsible for estate tax on insurance proceeds if, when added to the net worth of all other assets, the total exceeds \$1.5 million in 2004 and 2005; \$2 million in 2006 – 2008; and \$3.5 million in 2009; and in 2010, this tax is repealed. After 2010, the amount of the estate that is taxable returns to \$1 million unless the estate tax codes are amended.

The exception to this rule is when the surviving spouse is left all the proceeds of the estate; under Kentucky and federal law the spouse pays no estate or inheritance taxes. However, when the surviving spouse dies, his or her estate could have to pay estate taxes on the amount that exceeds the federal and state exemption.

### **ESTATE TAXES TIP**

The solution is to transfer ownership of a life insurance policy to the beneficiary to avoid having to pay federal estate taxes. However, be aware that if you die within three years of the transfer, the assets will be included in your estate. The owner can transfer ownership of a life insurance policy by completing an assignment form, which the insurance company will provide upon request.

Before making any changes, it is best to get advice from your attorney and other financial advisers. You might want to discuss the pros and cons of an irrevocable life insurance trust.

### **Should You Transfer Ownership?**

Think twice before you decide to make someone else the owner of your life insurance policy. While there may be estate tax benefits in transferring ownership, drawbacks do exist. You lose the right to change beneficiaries, and for policies with a cash value, you are no longer entitled to borrow the cash buildup or use the dividends. You also forfeit the right to cancel the policy or any of the other features provided. If the owner is not the insured and the owner dies, the cash value (if any) will be included in the owner's estate.

## ***Glossary of Helpful Insurance Terms***

A life insurance policy is a legally binding contract and, as with any other contract, you need to know what the contract actually says. Here are some commonly used insurance terms and their definitions.

**Primary Beneficiary (-ies)**—the individual(s) or organization who will receive money (called “death benefit,” “face value,” or “proceeds”) from the insurance company when the insured person dies.

**Contingent beneficiary (-ies)**—the individual(s) or organization who receives the proceeds if the primary beneficiary (-ies) dies before the insured dies.

**Insured**—the person whose life is covered by the policy. When the insured dies, the death benefit is paid.

**Owner (policyholder) of life insurance contract (policy)**—the person who exercises control over the policy. The owner can make any changes without the consent of anyone else, including beneficiaries, unless there are court-imposed constraints in place.

**Source for the Tax-Relief Act of 2001 – Turbo Tax website:**  
<http://www.turbotax.com/articles/TheTaxReliefActof2001.html>

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