John Hancock
LIFE INSURANCE

SALES STRATEGY

WEALTH TRANSFER | Advanced Markets

Municipal Bond Maximization

Repositioning Municipal Bonds By Using Life Insurance

The Concerns

Clients may have purchased municipal bonds because of the tax-free income they produce with the intention of transferring the bond principal at death, however, the value of the bonds may be depleted by estate taxes, leaving less money than intended for heirs. To solve this problem, clients can reposition these assets into something more efficient.

The Solution

Municipal Bond Maximization is simply a planning technique in which the bonds are used to fund life insurance. For example, your client could convert the municipal bond portfolio to a Single Premium Immediate Annuity (SPIA).[1] A SPIA provides an income stream for a chosen number of years based on a single deposit made to purchase the annuity, and the client's age and health status. For clients who need supplemental retirement income, a SPIA may provide a higher net income than the bonds. The client can then use part (or all) of their income to purchase a life insurance policy.

Another option would be for the client to retain their bonds and use their existing income generated by the bonds as premium for life insurance. In addition, if the client has an estate tax issue, they may want the insurance to be owned by an Irrevocable Life Insurance Trust (ILIT).[2] If the life insurance is owned by an ILIT, the trust will receive the life insurance proceeds free of estate and income tax.[3]

Benefits

- Life insurance can increase the amount left to heirs.
- Life insurance grows tax-deferred, cash surrender value can be accessed tax-free (through withdrawals and loans) and the death benefit can be received tax-free.
- Life insurance, depending on the state, can provide creditor protection.
- Life insurance, in a properly drafted ILIT, can help reduce estate taxes.

How it Works

Muni Bond Maximization is a strategy that entails two simple steps.

The first step is to utilize existing bond income or convert the bond to a Single Premium Immediate Annuity (SPIA) to secure a guaranteed (and potentially higher) income stream for life.

Then, the client can use all (or part) of the income to pay premiums on a life insurance policy.

Life insurance can be an efficient asset to transfer to heirs because the proceeds are not subject to ordinary income taxes when paid to the beneficiary at death. If the policy is owned by a properly drafted ILIT, it will not be subject to estate taxes either.

Considerations

- The SPIA approach generally creates a larger, guaranteed income stream, which means a larger potential premium and death benefit for the heirs. However, converting to a SPIA is irrevocable and liquidates the bond principal and may be taxable.
- The income only approach is sometimes preferred because it allows the client to retain access to the principal of the bonds. However, the income stream used with this approach is generally less than the SPIA, so less life insurance can be purchased.

- Plan requires evidence of insurability.
- Life insurance may have fees associated with it such as the cost of insurance.
- Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income. Policies classified as modified endowment contracts may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.

CASE STUDY: JAMES AND ELLEN WEINGART

CLIENTS:	James and Ellen Weingart
STATUS:	Ages 74 and 71, Preferred Non Smokers. The Weingarts have municipal bonds that they are not using for income. They have two children and want to maximize the inheritance that each child receives.
PRODUCT:	They purchase a Current Assumption Survivorship Universal Life policy, which buys approximately $1.8M of death benefit using a $30,000 premium.

COMPARISON OF VALUES IN YEAR 22

		CURRENT STRATEGY	PROPOSED STRATEGY
Bond Value Today		$1,000,000	$1,000,000
Total Premiums Paid by Year 22			$660,000
Municipal Bond in Year 22	+	$1,000,000	$1,000,000
Death Benefit in Year 22	+		$1,800,000
Saved Bond Income in Year 22 @ 3.00%	+	$943,587	
Net to Heirs in Year 22	=	**$1,943,587**	**$2,800,000**
Potential Gain Due from Planning			**$856,413**

The figures used in this case study are hypothetical, for discussion purposes only, are not guaranteed and may not be used to project or predict results. Actual results may be more or less favorable. Specific product and policy elements would be found in a policy illustration provided by an insurer. With any decision regarding the purchase of life insurance, a client would need to determine which type of life insurance product is most suitable for their specific needs.

SUMMARY

For clients who have municipal bond holdings that they intend to transfer to the next generation, but do not want to give up the income stream the bonds provide, municipal bond maximization may be an effective planning strategy. Illustrate the power of this concept by using JH Solutions.

For more information on Municipal Bond Maximization, please contact your John Hancock Representative or call the Advanced Markets Group at 888-266-7498, option 3.

1. A SPIA is a Single Premium Immediate Annuity that provides an income stream for a chosen number of years based on a single deposit made to purchase the annuity. The annuity income stream is calculated on a Life-Only No-Refund basis so that the income will last for the client's lifetime, or the joint lifetime of the client and spouse, if applicable, and no balance will be payable to the taxable estate at death. The SPIA guarantee is based on the claims paying ability of the insurer issuing the SPIA and John Hancock does not issue such contracts.
2. Trusts must be drafted by an attorney familiar with such matters in order to take income and estate tax laws, including generation-skipping transfer tax, into consideration. Failure to do so could result in adverse tax treatment of trust assets.
3. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are a few exceptions such as when a life insurance policy has been transferred for valuable consideration.

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IM1339 08/13 MLINY080913043

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