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Life insurance liquidity: Critical component of an overall estate/financial plan for real estate owners - by Patrick Di Cerbo

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Estate tax with an effective rate of taxation approaching 50% in larger estates, causes many real estate families concern. Life insurance is often considered as part of an overall plan to supply liquidity/cash at the inevitable death of an owner. The transfer tax from one generation to another can be more than all the income taxes an owner has paid in his/her entire life. The liquidity supplied by the life insurance may allow for a more effective transfer of assets.

It's no secret that in order to avoid or minimize estate tax, people contemplate giving away their assets before they die. When a person gives away a capital asset, such as real estate, the recipient has the mixed blessing of receiving property with carry over basis. Carry over basis means the recipient has the same cost basis as the person who gave them the property. If the property has been financed, then refinanced, and depreciated over the years, it can make it difficult to sell the property because of recapture. So, the owner of the real estate must make a decision; do I die with the property and receive a step up in basis and subject the property to estate tax, or do I give the property away during my lifetime burdening my heirs with carry over basis?

Whether one holds on to property to receive the desirable step up in basis or gives the property away to the next generation, subject to carry over basis, life insurance can play a role in mitigating the consequences. Life insurance can supply liquidity which allows for the payment of taxes more easily. Likewise, life insurance can allow for the redistribution of the gifted (predeath) property. It can allow for the heirs involved in the business to carry on with the assets and supply unencumbered cash to the heirs who wish not to be involved with the business. Life insurance can be a convenient way to supply cash at death to mitigate a variety of problems.

Most real estate developers who have been successful are so good at creating wealth, that they sometimes ignore the estate, financial, and liquidity planning that goes along with it. As sophisticated planners know, life insurance plays a critical role in estates both large and small. With a creative and knowledgeable service provider, it can be the difference between a plan that works and one that doesn't.

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