# Taking Stock: Answer to the million-dollar question

*by Malcolm_Berko*

Dear Mr. Berko: I'm an attorney in Cincinnati and sometimes agree with your harsh comments of members of my profession. It's often deserved but as often it's undeserved. I've been reading your column for years and have learned to respect your opinions and commonsense approach to readers' questions. Now I find myself in need of your expertise. A client recently received a $1 million insurance settlement. She's a wonderful and healthy 79-years-young lady who needs to earn no less than 7.5 percent after taxes on this sum, or $6,250 a month, or $75,000 a year (she's in the 25 percent bracket). I know that sounds like a lot of income for a single senior citizen, but for reasons I can't discuss, this income is vitally important to her. My client insists the $1 million principal be entirely intact so when she meets her Maker, all of it will pass to a very important great-grandchild. I've consulted with several brokers and advisers each of whom had suggestions but none could provide a tax-free risk-free 7.5 percent return plus 100 percent principal return. If you can provide this lady with a risk-free $75,000 a year in income plus a 100 percent return of her money you would be doing this wonderful lady a great service. However, I fear this might be impossible.

D.S.

Cincinnati

Dear D.S.: Difficult things are easy to do, but the impossible takes me a little bit longer. Your quest is far from difficult - if one will think outside the box.

It's possible to generate 10 percent to 12 percent returns with high-yielding preferreds and junk bonds. But their safety factor is not unlike lighting a (very tiny) match in a room of gas fumes. Hedge funds have produced some impressive positive returns during the past few years, but now they're beginning to produce some impressive negative returns, too. The yields on U.S. Treasuries, bank certificates of deposit, triple-A corporates, municipal bonds, etc., don't come within a league of solving your wonderful lady's problem.

However, there's an easy, commonsense, guaranteed and bankable solution. It's a combination of a single premium immediate annuity (SPIA) plus an irrevocable life insurance trust, or ILIT. Here's how it spills.

Invest that $1 million into a SPIA. Because your client is a female, age 79, a SPIA would pay her 12 percent on her $1 million, or $120,000 each year. At age 79, the amount of income excluded from taxation will be 85 percent. This exclusion lasts for her life expectancy, based on current government tables. So at her age, the exclusion will last for 11 years at which time she will be 90 or playing bridge with the angels.

Now the following example is going to get old-bone dry, but stick with me while I pound the numbers.

Your lovely lady would receive $120,000 (12 percent) a year from the SPLI and 15 percent of that amount or $18,000 is taxable. Because she is in the 25 percent bracket, she would pay (25 percent of $18,000) $4,500 in taxes and so her net after tax income would be ($120,000 less $4,500) or $115,500 annually, or $9,625 every month. That's 11.5 percent after tax return.

She will get $120,000 (before taxes) annually even if she lives to be 109 or 117 or 136 years old. That's the risk the insurance company takes. However, if she passes next year or four years hence, the insurer keeps every remaining penny of what's left. And that's the risk your client must take. But this doesn't solve the problem of a $1 million bequest to her great-grandchild.

Here's the $1 million solution: A $1 million life insurance policy will cost your client $36,000 in annual premiums, or $3,000 a month. So after paying and subtracting a $36,000 life insurance premium from the $115,000 SPIA income, your client keeps $79,000 in annual income, or $6,625 each month for every month she's vertical. That's a healthy 7.9 percent tax-free return and $4,000 of wiggle room from her necessary $75,000 yearly income. So when this lovely lady passes, the $1 million death benefit (owned by an ILIT) will be excluded from income and estate taxes. Now, my friend, seems to me that most complicated problems usually involve simple solutions. And I hope you will bill this lovely lady according to the solution.

Please address your financial questions to Malcolm Berko, P.O. Box 1416, Boca Raton, FL 33429 or e-mail him at malber@adelphia.net.

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