ADVANCED PLANNING

Legacy Advantage

AN ASSET REPOSITIONING STRATEGY

Life Insurance

Investment and Insurance Products:
Not Insured by FDIC, NCUSIF, or Any Federal Government Agency. May Lose Value.
Not a Deposit of or Guaranteed by Any Bank, Credit Union, Bank Affiliate, or Credit Union Affiliate.

Prudential

1009669-00004-00 Ed. 04/2021

Are you someone who:

- Is age 59½+ and family oriented.
- Has a minimum net worth of $1 million and sufficient liquid assets to support this strategy.
- Has assets that you do not intend to use during your lifetime and are not needed for support in retirement.
- Has a financial strategy that you have developed in conjunction with your financial professional that indicates that you have sufficient income from other sources to meet current and future retirement income needs and expenses.
- Wants to provide for and leave more to children or grandchildren.
- Wants to potentially enhance your legacy.
- Wants to counter potential losses to your legacy assets.

If this describes you, read on to learn how **Legacy Advantage**, a life insurance strategy, could benefit you and your family and help to preserve your assets for the next generation.

PRESERVE AND POTENTIALLY ENHANCE YOUR LEGACY

LEGACY ADVANTAGE CAN BE AN EFFECTIVE STRATEGY

Legacy Advantage can be an effective strategy that involves repositioning those assets that you do not expect to need during life (your legacy assets) to pay premiums for life insurance policy. The benefit of this strategy is that it can help you preserve and potentially enhance your legacy.

While there are benefits associated with this wealth strategy, there are also risks and potential tax consequences. You should consider this strategy only in situations in which you have assets that are not intended to be consumed during your lifetime and can be repositioned to pay permanent life insurance premiums.

Threats to Your Legacy

Hard work, sacrifice, and preparing for the future are why you have enough income to provide for yourself and your family. However, if your goal is to pass your wealth on to the next generation, there are a number of threats, such as taxes and chronic illness, that you need to consider. Without adequate preparation, these threats could erode the legacy that you plan to leave to your children, grandchildren, or favorite charity.

The Impact of Taxes

If you pass tax-deferred assets, such as an IRA, on to your beneficiaries, your heirs may be required to pay income taxes upon distribution. This could potentially erode the value of these assets. In addition, based on the size of your estate at death, federal and/or state estate taxes may also be imposed on your assets.

Do you currently have a strategy to help your legacy pass intact to your beneficiaries after your death?

The Risk of Chronic Illness

A chronic illness can be just as financially and emotionally devastating to your family as an untimely death. Someone turning age 65 today has almost a 70% chance of needing some type of long-term care services and supports in their remaining years;[1] this is an issue that can potentially impact you. Although 67%[2] of all chronic care is provided at home and the caregiver is typically a family member, there could still be financial impacts to you and the ones you love that you should consider preparing for.

Some life insurance policies offer a rider that, should you become chronically or terminally ill, can provide you with money by accelerating the death benefit (paying all or a portion of it to you over time and while you're still living). You can choose to use this money for any purpose, including to help pay for expenses. Such a rider may help you to avoid liquidating other assets. It's important to note, however, that accelerating the death benefit will decrease, or may eliminate, the legacy you were expecting the death benefit to provide to your policy's beneficiaries.

[1] U.S. Dept. of Health and Human Services, *How Much Care Will You Need?*, accessed March 2020 (https://longtermcare.acl.gov/the-basics/how-much-care-will-you-need.html).

[2] National Care Planning Council, *About Long Term Care*, accessed March 2020 (https://www.longtermcarelink.net/eldercare/long_term_care.htm).

UNDERSTANDING THE ADVANTAGE

Although there are many strategies to leave wealth to the next generation, Legacy Advantage can:

- Help **take care of loved ones** after your death.
- Provide a **generally income tax-free benefit**, according to IRC Section 101(a), that can help offset the income taxes owed by beneficiaries after receipt of the balance of the tax-deferred asset.
- Potentially increase your legacy through **tax-deferred growth**.
- Provide **accelerated life insurance death benefits** if you become chronically or terminally ill.

Legacy Advantage Can Help

If you have tax-deferred assets, such as an IRA, that you want to pass on to your heirs, you can choose to protect and potentially enhance the value of these legacy assets by using some of the asset itself or the income it generates to purchase a life insurance policy.

As long as sufficient premiums are paid, life insurance can provide a generally income tax-free death benefit to the policy's beneficiaries that can be predictable and will not fluctuate based on economic forces or market performance.

Some policies can also be paired with optional riders, typically for an additional cost, to provide expanded protection. For example, a rider may allow you to accelerate your death benefit to receive income if you become chronically or terminally ill or if you are permanently confined to a nursing home or need a life-saving organ transplant.

To execute the Legacy Advantage strategy, you could take a withdrawal from the asset or redirect its income, which may be subject to income tax, and use the after-tax proceeds to pay premiums on a life insurance policy with an optional rider for chronic and terminal illness.

Upon your death, the life insurance proceeds are generally received income tax-free. Your heirs can use these proceeds to help offset the impact of taxes on your legacy and potentially enhance the overall wealth they receive.

And if you become chronically or terminally ill, an optional rider could allow you, the policyowner, to advance a portion of the death benefit and/or receive monthly income.

However, any amounts accelerated under the rider will reduce the death benefit and may result in beneficiaries receiving less or no life insurance proceeds at death if the death benefit is fully exhausted while you are alive. While these types of riders are not designed to cover all the costs associated with a chronic or terminal illness, they can help you to pay expenses. Additionally, these riders are not long-term care (LTC) insurance or intended to replace LTC insurance, but rather are intended to be a supplement.

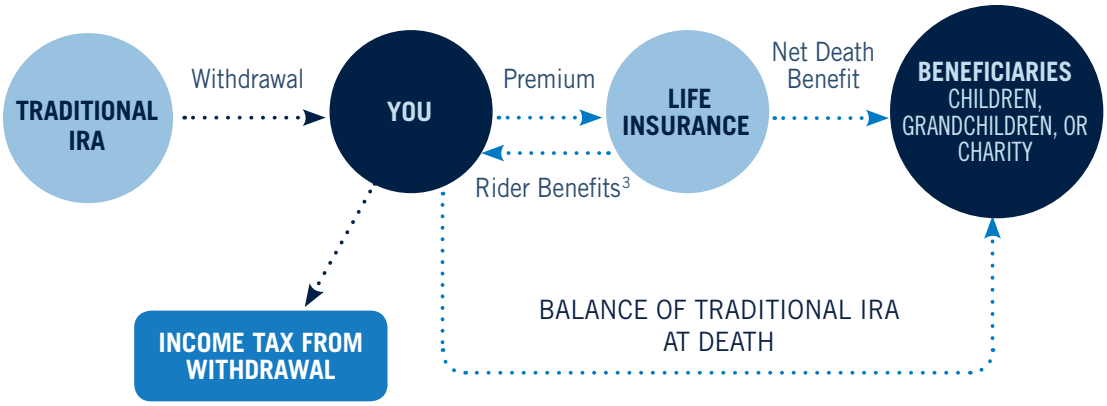
THERE ARE A FEW IMPORTANT THINGS TO KEEP IN MIND:

- Legacy assets may be found in a multitude of financial instruments and there may be income tax consequences that result from withdrawals and repositioning these assets.
- The hypothetical examples to the right and on the following pages only depict federal income taxes.
- If your estate is large enough, your legacy asset could be included in your estate and may be subject to estate taxes when it is transferred to the next generation. However, these hypothetical examples assume that your assets are not subject to estate taxes.

Legacy Advantage Using Life Insurance

As you can see in the diagram, the hypothetical client can begin taking distributions post age 59½ or use his or her required minimum distributions beginning at age 72 to purchase a life insurance policy with an optional rider for chronic and terminal illness.

After the insured's death, the death benefit proceeds from the life insurance policy are directed to the insured's children, along with the remaining value, if any, of the IRA.



BENEFITS OF THIS STRATEGY USING LIFE INSURANCE

- Can help replace income and provide for your loved ones following death.
- Provides flexibility to access the death benefit under a chronic illness rider upon being diagnosed as chronically or terminally ill and otherwise qualifying for benefits.
- Benefits are generally received income tax-free, which can help to offset the impact of income taxes for certain assets that are transferred to your beneficiaries upon your death.
- The death benefit is generally not subject to the price and interest rate volatility inherent in the equity and fixed income markets.
- May enhance the ultimate values received by heirs or a favorite charity.

[3]Chronic or terminal illness rider benefits may reduce or possibly eliminate the death benefit available to policy beneficiaries and may have other adverse consequences.

A Hypothetical Case Study

Client:
JUDY HILL, 68
Two sons

WILLIAM, 42

TYLER, 40

Judy, our hypothetical client, is a 68-year-old retiree with two sons. She would like to enhance and protect her legacy, and help protect herself against the potential financial impact of a chronic or terminal illness.

- **Assets:** $300,000 home, $1,000,000 of cash and investable assets, and a $700,000 IRA.
- Has income from a defined benefit plan and sufficient income from other assets to meet current and future income needs.
- IRA earmarked as legacy money.[4]
- Would like to leave more to her two sons.
- Concerned about the financial impact of unexpected costs associated with a chronic or terminal illness.

THE APPROACH

Let's assume that Judy takes **$20,000 of cash annually** to pay annual premiums on a life insurance policy with an optional chronic and terminal illness rider.

We are assuming a 5% rate of return on the IRA assets.

THE RESULT

Judy could, based on her age, health (Preferred Non-Tobacco), and product choice, obtain roughly **$631,849[5] in death benefit protection**. Either this value could be used to enhance her legacy, or the death benefit could be accelerated to provide her with funds if she becomes chronically or terminally ill as defined by the rider.

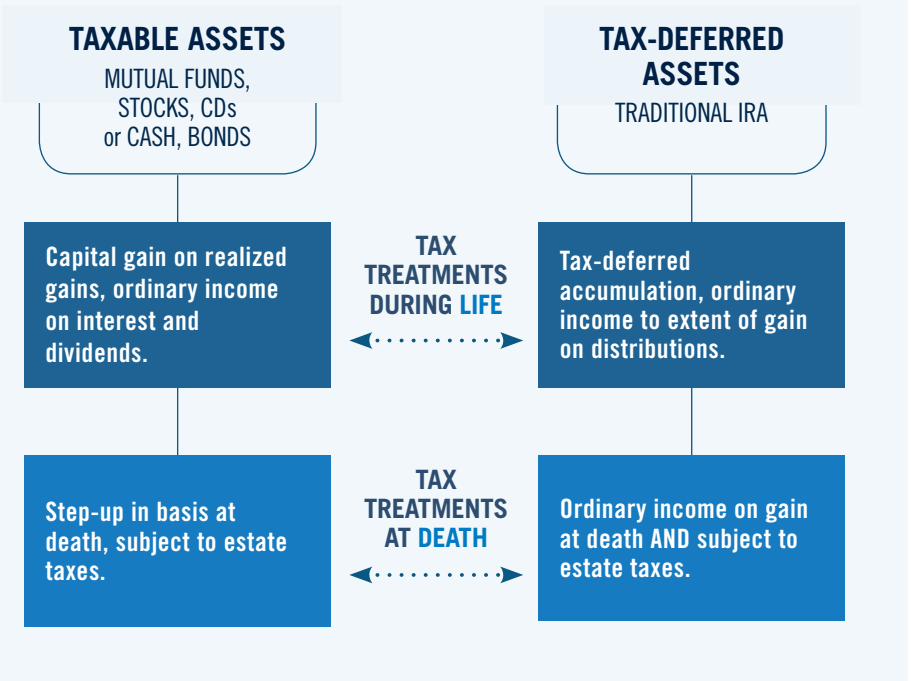
[4]Effective January 1, 2020, the SECURE Act requires many types of beneficiaries to completely withdraw all assets from inherited IRAs within 10 years and pay the resulting tax liability. The 10-year rule does not apply to some beneficiaries, such as surviving spouses, disabled and chronically ill individuals, minors, and those who are not more than 10 years younger than the account owner.

[5]This information is hypothetical and not representative of any particular product.

LIFE INSURANCE OFFERS A TYPICALLY INCOME TAX-FREE OPTION

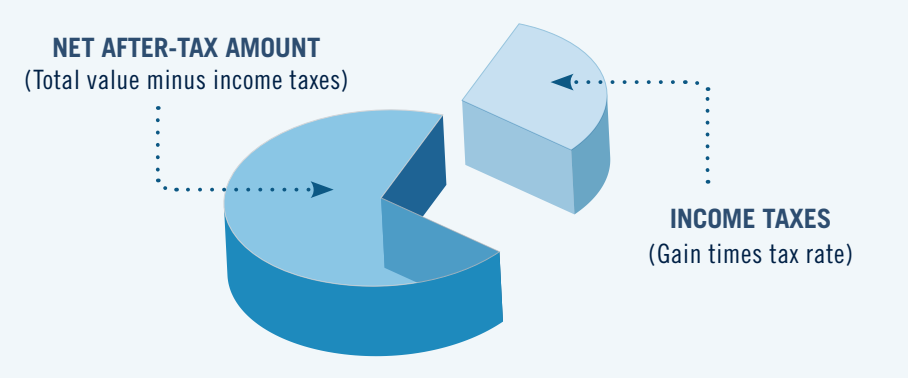
A significant portion of your legacy could be lost to taxes. If you pass a taxable or tax-deferred asset on to your loved ones, they will, depending on the value of your estate, be required to pay estate taxes. Additionally, your loved ones may also be required to pay income taxes after receiving the proceeds from your estate. Life insurance, however, pays a typically income tax-free death benefit to its beneficiaries, according to IRC Section 101(a).

TAXABLE ASSETS VS. TAX-DEFERRED ASSETS



Life insurance has fees and charges (including surrender charges) and may be less liquid than other "taxable" assets. Additionally, sufficient premiums need to be paid to keep the policy from lapsing.

TRADITIONAL IRA LIQUIDATION VALUE



Assumes the IRA is liquidated by one beneficiary at IRA owner's death as a lump sum subject to a tax rate of 37%. There may be other options besides lump sum available.

TAX RATE = Combined federal and state marginal income tax rates

GAIN = Total value minus cost basis (traditional IRAs may be 100% taxable)

ARE YOU PREPARED FOR A CHRONIC OR TERMINAL ILLNESS?

A chronic or terminal illness can be just as emotionally and financially challenging to your family as your untimely death.

Can you afford the cost of a chronic or terminal illness?

QUESTIONS TO CONSIDER

- Are you adequately positioned to handle the financial and emotional impact that your chronic or terminal illness could have on your family?
- Have you considered the effects of inflation on the cost of care?
- If you were ever to become chronically or terminally ill, would you have to sell assets to cover any related care costs?
- Have you considered the impact a chronic or terminal illness could have on your succession plan (i.e., financial legacy)?

REALITY CHECK

The estimated average out-of-pocket medical costs for a 65-year-old couple who retired in 2020 is **$295,000** … and even more if they become chronically ill.[6]

CONSIDER YOUR FINANCIAL AND EMOTIONAL WELL-BEING WHEN PREPARING FOR A POTENTIAL CHRONIC OR TERMINAL ILLNESS TO HELP PROTECT YOURSELF AND YOUR FAMILY.

A chronic or terminal illness can cost thousands of dollars each year. That can really take its toll if you haven't prepared for it. Not everyone will become chronically or terminally ill, but if you do, does your current strategy provide you with the additional income you may need to protect yourself and your family?

Adding a chronic illness rider to your life insurance policy can help you prepare for the financial impact of chronic or terminal illness, so the emotional one is a little easier. Note that the chronic illness rider benefits generally are paid directly to the policyowner, and can be used in any way he or she chooses.

[6] *How to plan for rising health care costs,* Fidelity, https://www.fidelity.com/viewpoints/personal-finance/plan-for-rising-health-care-costs 08/03/2020, Accessed 02/2021.

TALK TO YOUR FINANCIAL PROFESSIONAL.

If you want to leave legacy assets to your loved ones or a favorite charity, here are some questions to discuss with your financial professional to help determine whether this strategy is right for you.

LIFE INSURANCE

Prudential offers a variety of life insurance products and riders that can effectively help to protect or enhance your legacy.

QUESTIONS TO CONSIDER

- Would you like to leave a financial legacy to your children, grandchildren, or favorite charity?
- What is your monthly income need?
- What are you using to meet this need?
- If you die, will your spouse have sufficient replacement income?
- If you outlive your spouse, will you have sufficient replacement income?
- If you're currently taking, or planning to take, required minimum distributions from an IRA, do you need the after-tax cash for your lifestyle needs today or possibly in the future?

If not:

– Do you see yourself ever needing it?

– What do you plan to do with these assets and/or income?

If you plan to leave these assets to your loved ones or a favorite charity:

– Have you considered the effects of inflation?

– Have you considered the effects of market volatility?

– Have you considered the impact of income taxes?

– If you could potentially leave them more, would you want to learn how?

Important Considerations

BEFORE IMPLEMENTING THE LEGACY ADVANTAGE STRATEGY

- Any investment purchased during retirement involves the planning and use of your income or other assets. You should be certain to have sufficient liquid assets other than the asset or income you may be repositioning to support your current and future income and expenses before considering the purchase of a life insurance policy. Equity in the home should not be considered a liquid asset.
- You should consider developing a comprehensive financial strategy to take into account current and future income and expenses in conjunction with implementing the strategy discussed here.
- We recommend that you consult your tax and legal advisors to discuss your situation before implementing the strategy discussed here.

ABOUT LEGACY ADVANTAGE

This concept is only intended to be used for assets that will not be needed for living expenses for the expected lifetime of the insured. It is your responsibility to estimate these needs and expenses and it is recommended that you consider developing a comprehensive financial strategy in conjunction with implementing the strategy being considered.
The accuracy of determining future needs and expenses is more critical for individuals at older ages who have less opportunity to replace assets used for the strategy.

IF YOUR FINANCIAL OR LEGACY PLANNING SITUATION CHANGES

- If you need to use the assets or income being repositioned for current or future income needs and you can no longer make premium payments, the life insurance policy may lapse and the results illustrated may not be achieved.
- If the asset or income being repositioned becomes fully exhausted, premiums may have to be paid using other assets or income to keep the life insurance policy in force.

WHEN LEGACY ADVANTAGE MAY NOT BE IN YOUR BEST INTEREST

Depending on your life span, it is possible that your beneficiary may receive more by just inheriting the assets being repositioned, rather than by receiving the death benefit of the life insurance policy that was purchased.

TAX AND OTHER FINANCIAL IMPLICATIONS

- There may be tax and other financial implications as a result of liquidating assets within an investment portfolio. If contemplating such a strategy, it is important to understand that life insurance is a long-term strategy for meeting particular needs.
- The sale or liquidation of any stock, bond, certificate of deposit, mutual fund, or other asset to fund the purchase of a life insurance product may have tax consequences, early withdrawal penalties, and/or other costs or penalties as a result of the sale or liquidation.

ABOUT LIFE INSURANCE

- The death benefit protection offered by a life insurance policy can be a key component of a sound financial strategy.
- It is important to fully understand the terms and conditions of any financial product before purchasing it.
- You should consider that life insurance policies contain fees and expenses, including cost of insurance, administrative fees, premium loads, surrender charges, and other charges or fees that will impact policy values.
- If premiums and/or performance are insufficient over time, the policy could lapse, which would require additional out-of-pocket premiums to keep it in force.

A FINANCIAL LEADER FOR OVER 145 YEARS

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