Sales Strategy
Municipal Bond Maximization

JohnHancock
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Wealth Transfer Planning with Municipal Bond Maximization

THE CONCERN: LOW RETURNS AND HIGH TAXES

Due to estate tax uncertainty and the volatility of the stock market, many of your clients are reluctant to continue making cash gifts to family members annually,[1] or to continue with other planning techniques already established. Nonetheless, it is critical that your clients not abandon current planning or ignore opportunities for planning now since transfers to the next generation may still be significantly reduced by taxes. In addition, it will be important to consider the different ways to reposition existing assets to increase income and make them more tax-efficient for wealth transfer purposes. For instance, your clients may like the tax-free income provided by their municipal bonds, intending to transfer the bonds at death to heirs. However, tax-free municipal bonds do not generally provide the opportunity for high returns. Moreover, the value of the bonds can be depleted considerably by estate taxes even if the estate tax is reformed. Planning that includes repositioning an inefficient asset to maintain or increase current income, as well as preserve wealth for future generations, should be seriously considered.

THE SOLUTION: MUNICIPAL BOND MAXIMIZATION

Municipal Bond Maximization is a planning technique in which the bonds are converted to, or exchanged for, a Single Premium Immediate Annuity (SPIA).[2] A SPIA provides an income stream for a chosen number of years based on a single deposit made to purchase the annuity, and your client's age and health status. This approach assumes the use of a life-only no-refund SPIA in which an income stream is guaranteed to be paid to your client for life (or for the joint lifetime of client and spouse, if applicable). If an alternative annuity option is chosen when the SPIA is issued, there may be income and/or estate taxes that apply. For clients who need supplemental retirement income, a SPIA may provide a higher net income than the bonds.

Your client can then make gifts of a portion of the after-tax income generated from the SPIA to an Irrevocable Life Insurance Trust (ILIT).[3] The ILIT then has the funds to purchase a life insurance policy on your client's life for an amount that replaces or exceeds the value of the municipal bonds. Since the life insurance is owned by an ILIT, the proceeds will not be part of the taxable estate, providing that the trust is properly drafted. Potentially more can be transferred to heirs, estate tax-free, when a SPIA and life insurance policy work together using a Municipal Bond Maximization approach. *See following chart.*

THE PROBLEM	THE SOLUTION	THE RESULT
Low-yielding municipal bonds are subject to estate tax.	• Convert municipal bonds to SPIA. • Leverage SPIA income with life insurance.	Increase the amount transferred to heirs.

WEALTH MAXIMIZATION AND MUNICIPAL BONDS

In three simple steps, your client can maximize his or her municipal bonds and increase the amount transferred to the heirs. Here are the steps:

1) **Liquidate municipal bonds and purchase an immediate annuity with a life-only option.** If your client purchases an immediate annuity with a life-only option, none of the value of the annuity will be included in the taxable estate at death. The SPIA can provide an income stream, a portion of which can be used to make gifts.

2) **Use distributions from the immediate annuity for annual exclusion gifts to the trust.** Your clients can use the after-tax income to make annual exclusion gifts to an ILIT for children and other beneficiaries. In 2005, annual exclusion gifts of $11,000 per recipient can be made without gift tax consequences.[4] In addition, each person has a $1,000,000 lifetime exemption from gift tax.

3) **Trustee of the ILIT uses the annual exclusion gifts to purchase life insurance.** The ILIT will purchase a single-life or survivorship life insurance policy, and your client's heirs will be the trust beneficiaries. The trust should receive the proceeds of the life insurance policy free of estate and income taxes.

ADVANTAGES OF MUNICIPAL BOND MAXIMIZATION

- Municipal bonds can be sold with minimal income tax cost.
- SPIA income can replace the bond income without estate taxes.
- A SPIA can typically provide a higher return than municipal bonds.
- Life insurance inside an ILIT is generally free of income and estate taxes.[5]
- The ILIT proceeds can be used to maximize inheritances and transfer wealth to the next generation.

DISADVANTAGES OF MUNICIPAL BOND MAXIMIZATION

- Municipal bonds may have a lower investment risk than life insurance.
- Life insurance may have fees associated with it such as the cost of insurance.
- Unlike municipal bonds, SPIA income is subject to income tax.
- The exchange may be taxable and/or result in additional charges and/or risks.

CONCLUSION

For your clients who have large municipal bond holdings that they intend to transfer to the next generation, and who do not want to give up the income stream the bonds provide, municipal bond maximization may be an effective planning strategy. By implementing a municipal bond maximization strategy, your clients can maintain or increase income, and leverage a portion of the income with life insurance, outside the taxable estate. Your clients may "live better while leaving more" to heirs by using this strategy.

CASE STUDY: JAMES AND ELLEN WEINGART

Facts: James (74) and Ellen (71) Weingart are both non-smoker, preferred. They have an estate valued at $5,000,000, including $1,000,000 in municipal bonds. They have two children and want to maximize the inheritance that each child receives. Currently, the Weingarts receive $40,000 a year in municipal bond income.

Problem: James and Ellen want to implement a plan that will maximize their children's inheritance and reduce potential estate taxes. Most of their assets are tied up in real estate and other investments and they are reluctant to liquidate those assets. In addition, they want to retain the $40,000 a year in municipal bond income (after tax).

Solution: Municipal Bond Maximization

HERE'S HOW IT WORKS

James and Ellen will convert their municipal bonds to a Single Premium Immediate Annuity (SPIA). This will provide them with an annual after-tax income stream of $68,555 for life. They will keep $45,445 for supplemental income purposes and make a gift of the remaining $23,110 to an ILIT using annual exclusion gifts. The trustee of the ILIT will use the gifts to purchase a John Hancock Survivorship UL-G policy with a death benefit of $1,300,000 and an annual premium of $23,110.[6]

	AFTER-TAX ANNUAL INCOME (FROM BONDS OR SPIA)	GROSS ESTATE IN 19 YEARS (LIFE EXPECTANCY)	ESTATE TAX	ILIT PROCEEDS IN 19 YEARS	NET TO HEIRS*
RETAIN MUNICIPAL BONDS	$40,000	$9,767,705	$4,667,238	$0	$6,440,563
MUNICIPAL BOND MAXIMIZATION	$45,445 ($23,110 annual gift to ILIT)	$8,350,195	$4,120,901	$1,300,000	$7,286,900

The data shown is taken from an illustration. It assumes a hypothetical rate of return and is not a representation of expected future results. Unless indicated otherwise, these values are not guaranteed.

Conclusion: By implementing a municipal bond maximization strategy, James and Ellen are able to increase their income stream to $45,445 a year (after tax) and increase the inheritance for their children.

*Includes credit shelter trust proceeds of $1,340,096.

MUNICIPAL BOND MAXIMIZATION AND JH SOLUTIONS

The JH Solutions concept illustration system has a Municipal Bond Maximization module, which can aid you in showing this wealth transfer planning technique to your clients. In addition, John Hancock's Survivorship UL-G product is a flexible second-to-die product that provides competitive guaranteed coverage for any duration, and is a great wealth transfer-planning tool.

For more information on Municipal Bond Maximization, JH Solutions, and the Survivorship UL-G product, please contact your local John Hancock representative or call the Advanced Markets Group at (888) 266-7498, option 3.

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1. "How Bush's Budget Affects Yours," *Wall Street Journal*, February 4, 2003.
2. 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 USA does not issue such contracts.
3. 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.
4. The annual exclusion is $11,000 in 2005 and will be adjusted annually for inflation, in increments of $1,000. Creating and funding an ILIT is a sophisticated estate planning technique and your legal and estate planning advisor should be consulted prior to making any estate, tax, or investment decisions.
5. 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.
6. Survivorship UL-G is issued by John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116. This example assumes that the estate is growing at 5% after tax annually and that the sale of the municipal bonds does not result in income tax.

Insurance products are issued by John Hancock Life Insurance Company (U.S.A.), 197 Clarendon Street, Boston, MA 02116.

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