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How Will I Pay Estate Taxes?

Estate taxes. It’s not enough to simply know they exist and to know strategies to minimize them. When it comes down to it, you need to plan how you and your family will eventually pay them.

The Estate Tax Dilemma

Estate taxes are generally due nine months after the date of death. And they are due in cash. In addition to estate taxes, there may be final expenses, probate costs, administrative fees, and a variety of other costs. How can you be sure the money will be there when it’s needed?

Estate Tax Options

There are four main sources of funds to pay estate taxes. First, your current savings and investments. You or your survivors can use savings and investments to cover the costs of estate taxes, probate fees, and other expenses. This is often a sound alternative. However, sometimes savings and investments may not be sufficient. And if those savings were earmarked for other financial goals, you may need to rethink how you will achieve those goals.

Another option would be to borrow the money. Unfortunately, with this option you not only have to pay the estate taxes, but you or your survivors will be forced to pay interest on the amount borrowed to pay estate taxes. Remember to consider how your family’s credit standing will be affected by a death in the family.

The third option involves liquidation. If estate taxes are larger than the cash available to pay them, you or your heirs may have to sell valuable assets such as the family home, the family business, or other assets. Hopefully, they will sell for what they’re worth. In many cases, however, they don’t.

The fourth option — one that is often a prudent way to pay estate taxes — is life insurance.

What Can Life Insurance Provide?

Life insurance can provide a timely death benefit, in cash, that can be used to pay estate taxes and other costs. And it will be paid directly to the beneficiary of the policy, without being subject to the time and expense of probate.

Granted, life insurance does require premium payments. However, if appropriate to your situation, life insurance premiums can be looked at as a systematic way of funding future estate taxes. You get guaranteed liquidity and a death benefit that is generally free of federal income taxes. Indeed, the financial protection provided by life insurance can be invaluable to those who have the burden of paying estate taxes — your loved ones.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving insurance, it would be prudent to make sure you are insurable. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Any guarantees are contingent on the financial strength and claims-paying ability of the issuing company. Before you take any specific action, be sure to seek professional advice.

Coping with estate taxes may be a difficult proposition for you or your survivors. When it comes to paying them, life insurance may be a strategy worth considering, and overlooking it could be costly.

An irrevocable life insurance trust can be used to keep the insurance proceeds from being subject to estate tax at your death. There are costs and expenses associated with the creation and operation of a trust.

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