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Jean E. Krieger

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Personal Management

Life and Disability Insurance

Jean E. Krieger, CPA
Haskins & Sells
Columbus, Ohio

There are several reasons why a professional person would want life and disability insurance. This article will discuss the situations in which insurance is advisable and also present some of the alternatives available when selecting insurance.

Life Insurance

One of the basic reasons for buying life insurance is to provide for dependents. This includes care for a spouse, children, parents or the aid you may wish to offer your nieces and nephews to help them through college.

Life insurance is also a good source of funds for business buy-outs. A business buy-out agreement is often used when two or more people form a partnership or corporation and desire that the surviving partner(s) or shareholder(s) be permitted to continue the business. If the principle purpose is to continue the business, each individual should purchase life insurance on the life of the other(s). When one dies, the other(s) collects the life insurance proceeds, which are then used to purchase the deceased partner's or shareholder's interest from the estate or heirs.

Many estates are composed almost entirely of non-liquid assets such as real estate. These non-liquid assets may have to be sold quickly to provide cash to pay estate taxes. If the market is depressed at the time, value could be lost by making a quick sale. In this situation, life insurance would be valuable in that it could provide cash to pay the taxes. You may find it appropriate for your beneficiaries to own

the life insurance and use the proceeds to buy the non-liquid assets from your estate. This would get cash into the estate to pay the taxes and get the estate assets to the beneficiaries; it would also keep the insurance proceeds from being taxed in the estate.

Life insurance would also be valuable if you have a charitable organization you would like to help. Most colleges and universities will send you information about naming them as beneficiaries.

Disability Insurance

Disability insurance is a must for the person who relies on a salary. A prolonged illness can cause the salary to stop and leave the independent wage earner dependent on someone else for the necessities of life. Disability insurance can fill that gap by providing cash for living expenses during a prolonged illness.

Consequently, for the single person without dependents disability insurance becomes more important than life insurance. The disability insurance should be integrated with any wage continuation program provided by an employer. Social security benefits which could become available should also be considered when determining the amount of proceeds necessary.

Example

As an example of the considerations involved in determining an individual's insurance coverage, the following situation was presented to Joseph M. Berwanger, CLU of Columbus, Ohio, to evaluate the individual's insurance needs.

Marion Smith is 35 years old and is the proprietor of an accounting business which nets approximately \$20,000 per year. Marion's assets and liabilities are as shown in Chart 1.

	Cost	Market Value
Assets		
Cash	\$ 5,000	\$ 5,000
Receivables	- 0 -	10,000
Rental Property	60,000	100,000
Residence	25,000	49,000
Automobile and Personal Effects	15,000	8,000
Total Assets	\$105,000	\$172,000
Liabilities		
Mortgage on Rental Property		55,000
Mortgage on Residence		15,000
Total Liabilities		70,000
Excess of Assets over Liabilities		\$102,000

Marion's parents are living; both are retired and may need financial assistance from Marion in the future.

Mr. Berwanger presented the following insurance plan for Marion:

With Marion's family consisting only of her parents there is probably no need for insurance payable to them. Their expected future need of financial assistance can be provided through rental income from Marion's real estate holdings.

Her business will not need life insurance at this time. However, if she brings in a partner, she may want some type of funded partnership agreement to acquire the interest of the deceased partner.

Her estate should be looked at from the standpoint of liquidity needs. There should be enough cash in the estate for burial expenses and any medical bills not covered by insurance. But money will be needed for other estate costs. Chart 2 is a breakdown of estimated estate costs should Marion die in the near future.

Gross Estate	\$172,000
Administration Expense (4% of \$172,000)	6880
Debts Against the Estate	70,000
Total Administration Expenses & Debts	<u>-76,880</u>
Adjusted Gross Estate	\$ 95,120
Less Personal Exemption	<u>60,000</u>
Net Taxable Estate	<u>\$ 35,120</u>
Tax Payable (Less State Death Tax Credit	3,900
State Death Tax Payable (Ohio Rates)	<u>2,150</u>
Total Cash Requirements ..	<u>\$ 12,930</u>

In addition to this cash need of \$12,930 are the mortgages on the real property. If Marion dies after the mortgages are paid off, the adjusted gross estate will be higher, and the estate taxes will amount to \$33,280. But if she dies before the mortgages are paid off, her parents might find it difficult to refinance the properties due to their advanced age. Therefore, Marion should consider \$30,000 of permanent insurance (whole life) to solve the permanent problem of estate liquidity. The balance of her mortgage obligations should be insured with mortgage insurance.

Estate	\$12,930
Mortgages	<u>70,000</u>
Total — Insurance Need	82,930
Whole Life	<u>30,000</u>
Mortgage Insurance	<u>\$52,930</u>

Mortgage coverage of \$48,000 can be added to the \$30,000 whole life insurance as a rider at an added premium of \$124.25 annually. The total annual premium of \$798.25 can be paid in monthly installments of \$68.17. As the table below shows, the cash value rapidly equals the net premium. Marion can therefore pay the premiums under a minimum deposit basis. She should be sure to pay four premiums of the first seven — see No. 264 I.R.C.

More and more people are using insurance now to help their churches or schools. The premiums are generally deductible for income tax purposes, and the insurance proceeds provide needed cash for such organizations.

Marion must keep an eye on her estate. Her acquisition of additional non-liquid

assets could increase her estate costs at a tremendous rate due to her lack of the marital deduction.

Marion has an obvious need for disability coverage. If she is unable to work due to an injury or illness, her income obviously stops. Based on her present earnings her personal needs per month are probably about \$1,100. She should consider a 60-day waiting period, during which her accounts receivable would carry her, sickness payments for 5 years (after 2 years of sickness in 99% of the cases people are either well or dead), and lifetime accident insurance. The cost of this on a non-cancellable, guaranteed renewable basis is \$334.62 annually.

As this example illustrates, each individual's insurance needs vary according to the particular situation. This article was intended merely to help you evaluate whether you need life and/or disability insurance.

Selecting an agent is very important. A very large percent of the agents leave within two years. Since insurance is very complex, it normally takes several years for an agent to thoroughly learn the business so that he will be an effective counselor. Be sure to select an agent who will be receptive to your needs and will help you select the insurance which best fits your situation.

Year	Dividend	Net Premium	Cash Value Increase	Yearly Net Cost
1	—	674	162	512
2	72	602	548	54
3	89	585	559	26
4	105	569	568	1
5	121	553	578	(25)
10	225	449	547	(98)
20	372	302	611	(309)