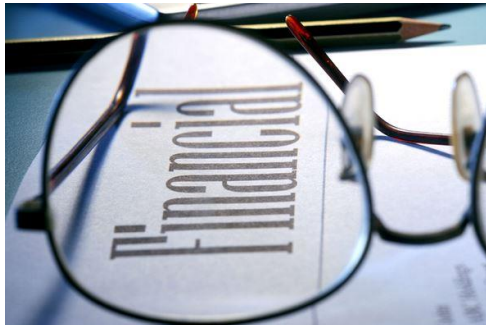


Policy Valuation: How Much Are You Worth?



A bidder at an auction purchased a Stradivarius and a Rembrandt for what he felt was an unbelievably low price. He took them to an appraiser to see if they were authentic. The appraiser informed him, “Yes, *they are authentic. It’s just a shame that Stradivarius couldn’t paint and that Rembrandt didn’t know beans about making a violin.*”

The common legal definition for fair market value of an asset is *the price on which a seller and a buyer can agree, neither being under any constraint and both being aware of all the circumstances.* Simple enough. So why is there so much confusion with regard to valuation of an inforce life insurance policy?

The need for a reliable value occurs often in the business, estate and financial planning process. And by “reliable” we mean one that the IRS will find acceptable, because usually the value is needed to calculate the tax consequences at the time of an ownership change.

The reason the IRS takes such an interest with life policies is, probably, because most transactions don’t involve parties whose opposing interests are characterized by a level of dynamic tension that will necessarily result in a fair and final value. Consider:

1. An employer distributing a business-owned contract to an employee-insured (e.g. distribution of a key person policy at retirement) may appreciate the corresponding business deduction, but probably would be happy to undervalue it to augment the benefit to a long-time employee by decreasing the amount he or she must recognize as income.
2. When a policy is distributed from a qualified plan, the stated value matters not at all to the plan trustee. But to the participant who must recognize the value as income (perhaps even with a 10% tax penalty) the lower the valuation, unrealistically or not, the better.
3. In a gifting situation the transferor of a policy is of a donative mindset anyway, so a lower value doesn’t reduce anything he or she might have received in return, except the size of a gift tax bill. So the lower the better, again realistically or not.

The difficulty is that neither Congress nor the IRS nor the courts have put together a reliable set of laws, regulations and rulings that allow for easy or certain valuation of a policy. Taxpayers must deal with a hodge-podge of criteria that vary with circumstances and with interpretation of the facts.

The good news for the insurance advisor is – *it is not your responsibility to determine value, nor should you try.*

Rendering an opinion is outside the scope of your legitimate professional activity. The best you can, and should, do is **offer to request from the carrier their “Form 712” valuations used by an executor in determining a policy’s value in an owner’s estate.** You will get back one or more numbers.

The most common is the interpolated terminal reserve, but many will also include: accumulated cash value, PERC value, premiums paid, cash surrender value, tax reserve, statutory reserve, etc. **Provide it to the attorney, CPA or appraiser to assist in their valuation. You’ve done all you can and more than most would.**

There is another story of an auctioneer who was interrupted when his clerk handed him a note. Reading it the auctioneer announced, *“A gentleman has lost a wallet containing \$500 in cash. If it is returned, he will pay a reward of \$100.”* After a moment someone in the audience shouted, *“\$150!”*

Call with any questions concerning policy valuation.