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Insurance Basics

If you go to any financial planning workshop, the opening discussion is likely to be about disability insurance. What is key to permanent financial security? The ability to earn a living. However, every wage earner has a statistical chance of a disabling illness or injury. If the disability is permanent it can be a personal and financial catastrophe.

Many employers provide some life insurance as a fringe benefit. Fewer of them provide any disability insurance coverage. Even so, any employer provided disability benefits are taxable income to the recipient because the policy was purchased with pre-tax dollars.

Benefits from an individually owned policy are tax-free. Getting an individual policy can be smart for two reasons: first, it is “portable” and will continue in force after a changing jobs; and second, while buying it the issue of how much disability insurance is needed can be carefully examined (instead of just taking whatever the employer chose).

I am sometimes asked by estate planning clients whether they have enough life insurance. I can’t give a quantitative answer because I do not have the training and software tools to do that analysis. I can say that they should have the amount they can afford that provides satisfactory security. I have two life insurance tips that are applicable to everyone.

(1) Watch your beneficiary designations. I have seen a parent (mistakenly) still on the policy as the primary beneficiary instead of a new spouse. I regularly see minor children as contingent beneficiaries. Keep that primary designation up-to-date and, for minor children, coordinate the secondary designation with the trustee named in your will, or in a separate trust. That trustee (not the guardian) will use the trust funds provide financial support to the children if both parents are gone until they are old enough to handle any inheritance.

(2) Don’t forget the economic impact of the death of a wife/mother. Whether she is a “working mom” or a homemaker, her possible death presents an economic risk that should be insured against.

In all cases the amount of life insurance provided by an employer should not determine how much insurance is needed. The premiums for the first \$50,000 of term insurance obtained through an employer is a non-taxable fringe benefit. Premiums for any more appear on the employee’s W-2 Form as taxable income. So, is it any surprise that \$50,000 of life insurance is the standard?

If one decides to go beyond the employer-provided policy, what to buy? Term life insurance, or a more permanent form, such as whole life, universal, or variable life insurance? Answering the question involves several issues. Is there is a temporary or permanent need for the insurance? How much premium is affordable? Is the life insurance going to be used to build up cash value inside the policy for a permanent economic benefit?

All of the insurance discussed above has involved a policy benefit being paid to the policy owner. Liability insurance does not pay to the insured. It pays “for” the insured. For purposes of our discussion, there are three common varieties of liability insurance: the liability coverage in practically all

homeowner's policies, the liability portion of automobile policy and finally "umbrella" liability policies which pay after a primary coverage from another policy, such as homeowner's or auto.

The most overlooked portion of the auto insurance policy is the uninsured motorist (UIM) coverage. It will pay the policyholder and members of his family for the damages negligently caused by another driver who had little or no liability insurance. A very large percentage of the drivers in Georgia have no insurance or the statutory minimums. How much UIM you get is a personal comfort issue. I would not want to have less than \$300,000.

Don't forget the medical expense coverage available in your auto policy. It will pay your medical bills arising from any auto accident without regard to any at-fault determination. That could be important if you have a high deductible on your medical insurance.

It would be nice to be able to include a discussion of medical insurance, but unfortunately federal tax law has taken the whole subject of medical expense payment into a realm far away from the economics of insurance purchased by individuals to address risk. Addressing risk is what insurance is all about. If you understand that, then you know the basic principle of insurance.

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Patrick J. Gibbs practices law in Roswell, Georgia with a concentration on Wills, Trusts and Estates. This article is intended to be educational. Legal advice should be obtained as to individual needs before taking any action.