**Should a Life Insurance Agent (with a Whopping Two Days of Training) be allowed to perform a “Quick Overhaul” of Elderly Veterans Investments? Possibly Costing the Veteran $170,530 in taxes?**

**Two Major Insurance Companies say NO!**

Article By: Gilbert Fleming, Esq.

Two major life insurance companies, Aviva Life Insurance, and American Equity Insurance recently announced that they will not accept annuity business written in conjunction with marketing programs targeted at elders that promote qualification for Veterans Administration benefits.

I believe this is partially in response to an article in the *AARP Bulletin* entitled *Taking Aim at Old Soldiers.* [[1]](#footnote-1) The Author, Sid Kirchheimer, described “unscrupulous investment advisors” posing as “veterans’ advocates” giving seminars to elderly veterans. They promise to get them “instant eligibility for benefits through a quick overhaul of their investments.”

Mr. Kirchheimer goes on to say that the “quick overhaul of their investments” involves annuities, “which are long-term investments that are often considered inappropriate for older retirees…they are recommended because they generate high sales commissions.”

American Equity, one of the insurance companies that is cracking down on this practice, stated, “there is a potential for these (prospecting strategies) not to provide adequate disclosure to prospects. Without proper advice there is a possibility of *adverse tax consequences*....”

**Adverse tax consequences due to a quick overhaul of a senior citizen’s investments? You better believe it!**

Recently, I received an e-mail invitation to a seminar teaching how to use life insurance annuities to qualify veterans to receive benefits. As an Elder Law Attorney, I am constantly looking for ways to use VA benefits to help elders pay for their long-term care. I am open to learning about any tool available. I disclosed to the lady who took my credit card number that I was an attorney, and she happily billed me $800 to attend this class.

The class was taught by an insurance agent who called herself a multimillion dollar a year annuity producer. On the first day of the class, she taught us how to invite senior citizens to breakfast seminars. We were to memorize her power point presentation word for word. For example, we were NOT selling an annuity. We were selling a “VA acceptable income plan.”

And mind you, when she said to memorize this word for word, she meant WORD FOR WORD! She claimed that her power point has been “reviewed… and approved by the VA Public Affairs Department.” If we changed anything, we could face a “complaint” by the VA, which would send “plants” to our breakfast seminars and observe our presentations.

I’m not convinced that all of the attendees really UNDERSTOOD what was taught in the seminar, but they were certainly convinced to memorize it and repeat it word for word.

**The next day, it became more interesting. Now we learned about the “quick overhaul” of a veterans investments.**

The multimillion dollar producer explained that the VA would provide up to $1,949 per month in benefits, but only if the veteran’s assets were less than a certain amount. She told us if a veteran was over 90 years old, they could only have $29,000 of assets in their own name. If they were over 85, they could have only $39,000. But if they were 84 and under, they could have $49,000. The remaining assets, including their home, must be taken out of their name.

I raised my hand and asked where she got these amounts. I said that I had never heard of such a rule. Did she get these amounts from a statute or a regulation or what? She smugly smiled and said it came from her sources at the Veterans Administration.

An attorney works with the multimillion dollar annuity producer. He writes lots of Irrevocable Veterans Trusts for $750 apiece. He said that elderly veterans must immediately put all of their excess assets into one of his Irrevocable Veterans Trust. The trust requires that the elderly veteran “have no power to control and direct payments out of the trust, to remove trust property, to alter, amend, revoke, or terminate the trust in whole or in part.”

The attorney never gave me a chance to read his trust. But as I understand trust law, renouncing personal ownership of an individual’s investments and placing them in an irrevocable trust very well may create unexpected income tax consequences.

I mentioned this to the attorney. I mentioned my father-in-law, a World War II veteran who just sold his home to help pay for his assisted living expenses. Thankfully, he did not have to pay any capital gains taxes at all, because it was his personal residence. Even in a down market, my father-in-law was able to get $200,000, tax free[[2]](#footnote-2). This saved at least $30,000 of federal capital gains taxes.[[3]](#footnote-3)

I was quite surprised when the attorney didn't seem to know about this tax-saving strategy. And he didn't seem to know whether or not this tax savings would disappear if the veteran transferred his house into this irrevocable trust.

Finally, the multimillion dollar insurance producer used several hypotheticals to demonstrate how a “quick overhaul” of a veteran’s investments can get him instant eligibility for benefits.

**But let’s just discuss the case of Mr. and Mrs. Smith. Their “quick overhaul” may have cost them $170,530 in federal taxes:**

Mr. and Mrs. Smith are in their late 60’s. One has severe diabetes, and the other has already had a stroke. It seems with their health issues, they could benefit from living in a nice assisted living facility. To receive the VA benefit of $1949 per month (which would help them pay for a nice assisted living facility), they can own no more than $49,000 in their own name (according to the insurance producer). But they own:

One house free and clear

I.R.A.’s totaling $317,000

One variable annuity, purchased in 1997, worth $325,000

The multimillion dollar producer recommended a “quick overhaul” of these investments by placing everything, including the home, in an irrevocable veteran’s trust. Then they would sell all the assets and use the funds to purchase an annuity.

**But she never suggested the tax ramification of this “quick overhaul”.**

Later, I ran this hypothetical through Turbo Tax. Turbo Tax told me that the Smith’ tax bill, due and payable on April 15 of 2012, could be as much as $170,530.

For example, when Mr. and Mrs. Smith cashed in their Individual Retirement Accounts worth $317,000, this *entire* amount was added to their 2011 taxable ordinary income. An I.R.A. is meant to be taken out slowly over the years and taxed a little at a time. When they withdrew the entire I.R.A. in one year, they had to pay ALL the tax on the I.R.A. in that year. This almost certainly put them in a high tax bracket.

And consider the house: I used my father-in-law's house when I estimated this transaction and entered it into Turbo Tax. I realize that the value of houses varies wildly across the country. In some areas of the country, my father-in-law's house would not have fetched $50,000. In Beverly Hills or the Silicon Valley, it might be worth $1,000,000.

Finally, how do we compute the additional taxes on the variable annuity, worth $325,000, that Mr. and Mrs. Smith owned for 15 years? It would be helpful to have the amount they paid for it in 1997. Then we could calculate the gain over the last 15 years.

One of the benefits of a variable annuity is that the gain is not taxed as long as you leave the money in the variable annuity. It is only taxed when you begin to withdraw money. This is another asset which is meant to be taken out slowly over the years and taxed slowly. But when the Smiths withdrew the entire $325,000, they were taxed on ALL of the gain over the last 15 years in one lump sum. Due and payable on April 15th of 2012.

Did this annuity double in value over the last 15 years? I hope so. For Turbo Tax, I assumed that the annuity had doubled in 15 years. Mr. and Mrs. Smith paid $162,500, and had $162,500 taxable gain, to be paid on April 15, 2012.

**And what about the annuity that the Smiths bought?**

The multimillion dollar producer spoke highly of an annuity that had a 9 year surrender penalty, meaning they did not have full access to their money until they were in their late 70’s. If there were an emergency, and they needed their money NOW, they would pay a 15% early surrender penalty in the first three years after they bought the annuity. In year five, they would pay a 13.5% early surrender penalty. The surrender penalty continued declining until it expired in year ten.

Mr. Kirchheimer, the author who wrote the piece for the AARP, describes the high sales commissions on annuity products. If the Smiths had bought the annuity, the salesman would get a commission of nine percent!

So in this hypothetical, hopefully a worst case scenario, Mr. and Mrs. Smith sell the house, their IRA, and their variable annuity. They create a pot of cash worth at least $840,000, and they buy an annuity. The salesperson gets a commission of $75,600.

But Mr. and Mrs. Smith get a tax bill, on April 15, 2012, of $170,530.

Maybe the Smiths have no choice but to take the $170,530 out of their annuity to pay their tax. But they will suffer a 15% early withdraw penalty of $25,579.

True, the Smiths potentially get a VA pension as high as $1,949 per month, which equals $23,388 per year (tax free, indexed for inflation). But it takes over seven years for this payment to equal the 2012 tax bill and it takes an additional six years to pay for the early withdrawal penalty. Only after the year 2019 can Mr. and Mrs. Smith actually enjoy their VA benefit.

In summary, I am glad that life insurance companies like Aviva and American Equity are taking steps to curb this practice. I only hope that other life insurance companies follow suit.

1. http://www.aarp.org/money/scams-fraud/info-09-2010/taking\_aim\_at\_old\_soldiers\_.html [↑](#footnote-ref-1)
2. He bought the house for $50,000 many years ago. He sold it for $250.000. [↑](#footnote-ref-2)
3. This is due to the Section 121 Capital Gains exclusion, which allows a single person to take up to $250,000, tax free, from the sale of his home. A married couple can take $500,000 [↑](#footnote-ref-3)