

## **The Estate Planning Advisor**

**By Richard J. Shapiro**

### **“Free” Life Insurance? Think Again!**

Over the past few years, seniors nationwide have been targeted with a sales pitch for what is commonly referred to as “stranger-owned” life insurance (“STOLI”). The salesperson tells you that all you need to do is apply for a new life insurance policy insuring your own life. They often recommend a policy with a face amount of a million dollars or more. The policy will cost you nothing, as a third party lender will provide you with no-risk financing to cover the premium payments. You will retain ownership of the policy for a short term, typically about two years. If you die within the two-year period, your beneficiaries will receive the entire death benefit, less the amount needed to pay off the loan used to fund the insurance premiums. If you survive the two-year window, then you will agree to sell the policy an “investor.” In return, you will receive funds to pay off the loan, commissions, and you will get to keep the extra cash as a profit.

While the STOLI concept seems like a great deal on its face, it is not a legal or legitimate transaction. In order to obtain life insurance on the life of another person, you must have what is known as an “insurable interest” on the life of the insured. Spouses, children, employers or business partners can have an insurable interest. “Strangers” simply do not fall into the class of persons who would have a legitimate insurable interest on your life. Purchasing life insurance for yourself, with a pre-arranged agreement to sell the policy as described above, would almost certainly be considered insurance fraud under the laws of any state. Participation in such a transaction can leave you exposed to both civil and criminal liability.

Even if STOLI were a legitimate concept, there are other practical issues that should cause one to avoid these transactions. First and foremost, the ultimate owner of the policy will benefit from your “premature” death. Keep in mind that for every year you live, a premium payment must be paid, and the investor’s “rate of return” diminishes. Also, the policy may be sold by the original investor (and re-sold multiple times). Do you really want a total stranger benefiting from your premature death?

There are other negative aspects to STOLIs that need to be considered. The amount of death benefit that a person may have on his or her life at a given time is limited, and if a large STOLI policy is put into place, you might be precluded from obtaining additional insurance that would benefit your family. In the event you receive any monetary benefits as a result of the STOLI transaction, those benefits may be considered taxable income to you. Also, the investors are not bound to purchase the policy at the end of the two-year term, forcing you to pay off the bank loan and begin paying the premiums yourself, or surrender the policy to the bank and possibly causing the IRS to count the discharged debt as taxable income. And finally, there is no guarantee that the investors will in fact buy the policy from you at the expiration of the two-year term, especially if they determine that you are likely to live longer than was originally projected. Such a scenario might leave you owing hundreds of thousands of dollars to the

original lender, including interest charges and brokerage fees, and you may not have enough cash to cover the loan.

Keep in mind that STOLI should *not* be confused with the life settlement market. In a life settlement, a policy owner who initially took out a life insurance policy for family or business reasons may later determine that the insurance is no longer needed. In such cases, the policyholder can legally sell the policy to one of a number of companies that specialize in purchasing such policies on the open market. A life settlement is a legitimate planning tool, while STOLI is an illegitimate scheme in every respect.

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