

# Lessons of preparedness from Hurricane Katrina

If there is one important lesson that we have all learned from Hurricane Katrina what would it be?

**GUEST COLUMN**

**Lori C. Adamo**

As the head of a business-continuity services company that promotes emergency preparedness, this question remains a burning one with a single compelling answer: The lesson learned, and a costly mistake, is the lack of planning and readiness.

Katrina is one of the biggest natural disasters in U.S. history and the experts knew how the levee would react to a hurricane of this magnitude. Sadly, their predictions were correct.

Is it that the good folks in Louisiana didn't heed the warning? Is it that they thought they would get by with luck or by the grace of God? Where were the disaster plans and emergency operations plans that Homeland Security funded with millions of dollars?

They encourage communities to plan for their own safety and well-being. Plan so that in the event of a major disruption they will stay whole, keep their economy running, and keep their people safe.

The American Farm Bureau Federation estimates that there could be a \$500 million export loss for U.S. producers through the Gulf ports. There are grow-

ing concerns that the combination of higher energy prices, transportation disruptions, and lower economic activity in the Gulf region itself, could be enough to plunge the economy into an actual recession.

One estimate puts the economic cost of Katrina at more than \$100 billion. The Wall Street Journal estimates the cost of caring for victims of Hurricane Katrina and rebuilding the areas it destroyed could cost the federal government up to \$200 billion, much higher than previous estimates.

Also, the Congressional Budget Office estimates that Katrina could cost the country more than 400,000 jobs and shave up to 1 percent off the nation's economic growth in the second half of the year.

If you think that the events that are now unfolding in New Orleans from the aftermath of Katrina cannot happen in sedate New England, then think again.

Recent emergency events have happened here in Rhode Island not nearly the magnitude of a category 4 or 5 hurricane and have caused tremendous destruction. Will we be ready as a state, as a business, as a community, if a natural or man-made disaster were to hit our region?

We have all read about the shortcomings that have plagued our state, and the federal govern-

ment has said that preparedness planning is key. So are we assessing our vulnerabilities, creating contingency plans and practicing these plans? Or do we think we will be the lucky ones unscathed by disaster and have the attitude that it just can't happen here?

Businesses need to take responsibility for their own welfare and continuity. We cannot be at the mercy of bureaucratic agencies fighting turf wars while our businesses suffer. Both businesses and citizens alike must take measures to protect their people, property and welfare in the event of a natural or man-made disaster.

Businesses can take protective measures by assessing the risk of what could happen in a worst-case scenario and then develop an emergency action plan to address their most pressing needs in the event of an emergency.

The most important lesson to be learned from the events of Hurricane Katrina is that our government is unable to provide the level of protection that we have come to expect. The private

sector must take it upon itself to ensure continued viability in the marketplace in the aftermath of a disaster and realize that our government with all its vast resources can only do so much.

Recently, I had the opportunity to listen to many of our U.S. senators in Washington, D.C., talk about this catastrophic event.

Sen. Susan Collins, R-Maine, chair of the Senate Committee for Homeland Security, stated that as we begin to determine where FEMA and Homeland Security went wrong, businesses must immediately take a look at their own vulnerabilities and begin to prepare for disruption. She defined the three R's of emergency preparedness as **R e a d i n e s s**, **R e s p o n s e** and **R e c o v e r y**. Take heed in this definition, as you will hear much more in the weeks and months ahead.

The Rhode Island business community must begin to assess, plan and train their employees to assure that this type of failure will not happen.

It is clear that the plans used during this emergency did not

meet the minimum objectives. Had validation testing and training been a top priority of the end-users of the respective plans, it would have been clear to them that change was necessary to increase effectiveness.

At times like this we need to evaluate our own emergency preparedness. Businesses must provide leadership that is effective and defined while delegating clear and concise emergency preparedness and acquire rapid marshalling of resources. This is not done at the time of a crisis. It takes place when there is time to think and reconsider the various options. Testing and training requires commitment of resources to refine, evaluate and increase effectiveness of your plan and leadership is key.

Stakeholders, stockholders, boards of directors and small-business leaders alike must commit resources before an emergency strikes our area. Businesses must realize that it is critical to develop an effective and well-designed plan that is executed by well-trained emergency professionals or suffer the tragic loss of life and viability that poor planning and performance brings. ■

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# Using a life insurance trust to avoid the estate tax

So you bought a life insurance policy to protect your family and your assets?

Whether that's a good move may depend on how you handle the life insurance.

For example, while life insurance proceeds are exempt from income tax, they are not necessarily exempt from estate taxes. If your estate receives the proceeds of your life insurance policy, thereby boosting the value of your estate over the current \$1.5 million threshold, it will be subject to federal estate taxes at a marginal rate of 45 percent or more. This threshold is not hard to cross these days, given the hyper real estate market. Or if the policy was issued within three years of your death, the IRS could end up with almost half of the proceeds, regardless of the value of your estate.

With careful structuring, however, you may be able to avoid these pitfalls and use life insurance as a key financial planning tool so that the proceeds get to the people you intend to protect.

If a life insurance policy is owned by an irrevocable life insurance trust (ILIT), the proceeds may avoid the estate tax. In addition, the proceeds may bypass pro-

bate, allowing the cash to get to your heirs much more quickly.

An ILIT is typically created by establishing a standard irrevocable trust. After an attorney drafts documents naming the trustee and beneficiaries, the insured periodically deposits cash into the trust, in essence paying the policy's premiums.

When money is deposited into the ILIT to pay the insurance premiums and/or the trustee's fee, that cash is considered a gift to the trust's beneficiaries.

If structured properly, the gift will qualify for the \$11,000 annual gift exclusion. If the amount deposited exceeds the annual exclusion of \$11,000 per recipient, then you become subject to a gift tax. (The gift tax is essentially the same as the estate tax, but payment of the gift tax reduces the amount of credits available to offset potential future estate taxes.) You may offset the gift tax with your unified credit, but once the unified credit has been fully used, you are into paying the gift tax.

If the premium payments create a gift tax, you can explore creative ways to avoid it.

For example, compensation arrangements between you and your beneficiar-

ies may allow you to deduct payments made to them as compensation. They, in turn, could use the after-tax portion of that compensation to fund the policy's premiums. Or it may be possible for you to loan them the money to make the premium payments.

Upon your death, the trust receives the policy's death benefit.

Thereafter, the proceeds can be distributed to the trust's beneficiaries. The beneficiaries can choose to do what they want with the proceeds. However, to avoid significant estate tax, they will likely opt to put the cash back into your estate in exchange for business interests or other property owned by your estate, almost as if they were buying your property from your estate. As the basis in the property will be stepped up to fair market value, the estate should not realize a gain on the sale, subjecting it to income tax.

ILITs may be one of the easiest and least expensive ways for your family to avoid significant estate tax. It could also help provide them with the liquidity they will need to protect their interests in your property.

**EXISTING POLICIES**

When you transfer an existing policy

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to the trust, the transfer must take place more than three years prior to your death for the estate tax to be avoided.

Therefore, it is always better for the trust to be the owner of the policy at the time of issuance.

Additionally, consider borrowing the cash surrender value before the transfer. Otherwise that cash surrender value will be considered a gift to the trust's beneficiaries.

Remember, ILITs are irrevocable and they cannot be amended. If, for example, you later decide to change beneficiaries, your only choice may be to stop funding the premiums altogether, risking the security of your assets due to a lapse of coverage. Additionally, you cannot borrow from the policy, nor can you retain any power to give instructions to the trustee, as the IRS may consider the integrity of the trust to be breached and can require that the insurance proceeds be included in your taxable estate. Therefore, it is crucial that the trust be properly crafted.

*This has been a general discussion and is not intended as actionable advice for any person or organization. Always seek professional counsel for important decisions.*

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