



SECURING YOUR FUTURE

EXPLORING THE IMPORTANCE OF LIFE INSURANCE AND AVAILABLE OPTIONS

Life insurance is universally recognized as an essential pillar of a financial plan for providing much needed capital in the event of loss of a breadwinner. It is also fundamental to other planning needs, such as estate planning to pay for settlement costs and taxes, and business planning for business continuation or key person protection. However, considering the remarkable tax properties of permanent life insurance, it should also be considered as foundational planning tool for an entire financial plan.

The thought of buying life insurance is not something that most people relish, yet, if it is done right, it can provide the greatest peace-of-mind a person can have. An untimely death can have a major financial impact on those left behind, particularly if there is a mortgage to pay, credit card debt, or an outstanding auto loan. Even final expenses can be a burden. The key to life insurance is to do it right. Following this helpful advice may ease the burden and have you feeling good about your purchase right from the beginning.

Life Insurance Options

There are a variety of life insurance policy options that you can choose from, with each designed for the specific needs of the insured. The more common types of life insurance include:

- **Term Life Insurance-** Term life insurance provides protection for a very specific period, with the premium typically remaining the same throughout that period. For instance, if you take out a \$500,000 term life insurance policy for 20 years, and die in year 19, your designated beneficiary will receive the \$500,000 tax free. However, if you do not die during that 20-year term, the policy simply expires. Most term life policies offer an extension at the end of the term, but the premium will rise substantially if the policy is extended.
- **Universal Life Insurance-** Universal life insurance offers a lot of flexibility that a term policy does not, though premiums are much higher for a universal life policy than a term life policy. The reason for the higher premiums is that a portion of the premium paid monthly or yearly is divided between the cost of the insurance, and a cash value policy. The cash value policy allows the policy cash value to build over time, on a tax-deferred basis, while also allowing policy holders to determine the level of death benefits they wish to derive from the policy. In addition, upon your death, beneficiaries will receive the death benefit as well as the cash value portion of the policy. Another nice feature is that universal life policy holders can change the amount of the premium by changing the amount of death benefit, and can move funds between the insurance portion and the cash value portion of the policy.

- **Whole Life Insurance**- Whole life insurance is permanent; designed to remain in force throughout the life of the policy holder, provided that premiums are paid on a timely basis. Like universal life, whole life insurance premiums are typically much higher than term life premiums. Like universal life, whole life policies also have a cash value, with part of the premium being invested. However, unlike universal life, beneficiaries will only receive the death benefit portion of a whole life policy upon your death, as the cash value of a whole life policy is designed to be used by the insured during his or her lifetime.

Financial Benefits of Life Insurance

1 Increased After-Tax Income in Retirement

While IRAs and 401(k) plans are considered essential retirement planning tools, they have several disadvantages. The first is they are merely tax-deferred vehicles. Although that is an advantage while accumulating capital, it can be a big disadvantage during the distribution phase. Taxes are due on distributions when the money is needed most and at an uncertain tax rate. That makes these traditional retirement vehicles uncertain at best and a diminishing asset at worst.

By converting these accounts over time into a permanent life insurance plan, tax-deferred becomes tax-free when the income is needed. Also, income taken from cash value life insurance is not included in the Social Security tax calculation as is the income from IRAs and 401(k) plans.

This can be especially advantageous when having to deal with required minimum distributions at age 73 (this changes to age 75 starting in 2033), which can force you into a higher tax bracket. By taking distributions from an IRA or 401(k) plan and funding a life insurance policy, you can reduce your retirement plan balances to avoid a possible RMD problem while creating a reservoir of tax-free income.

2 Improved Investment Performance

You might be wondering if life insurance should ever be used as an investment. Some advisors view life insurance as an expense. While there are additional costs associated with life insurance, there is no other asset that can perform the way a permanent life insurance plan can, especially for long-term objectives such as retirement.

As an investment, life insurance not only removes the tax risk associated with most other vehicles, it provides a valuable hedge against stock market volatility and interest rate risk associated with bonds. Depending on the type of permanent life insurance, it also provides guaranteed returns. Investment models have shown that, when cash value life insurance is included as an asset in an investment portfolio, it can increase long-term investment performance while reducing portfolio volatility. By any measure, that is not an expense.

3 More Control Over Income and Taxes

Most people don't think of life insurance in terms of what it can do for them while they are living. However, considering that cash value life insurance is the only type of asset that can allow you to accumulate capital tax-free and take tax-free withdrawals (up to the cost basis and thereafter as tax-free loans) anytime without penalty, it is unparalleled in its planning opportunities.

Most investment income can potentially trigger stealth taxes, such as alternative minimum tax, Social Security tax on income, or the 3.8% additional tax on net investment income. It can also increase taxes by pushing your income up through qualification thresholds for phased-out deductions, tax credits and exemptions. Income taken from life insurance is not considered investment income; therefore it can actually lower your taxes.

By the way, all the while you have been enjoying the tax benefits of life insurance, you have substantially expanded your legacy estate with a tax-free death benefit.

While life insurance should be viewed by most people as an essential protection vehicle, when used in the right situations, the remarkable properties of life insurance should be viewed as a gift for people who have portfolios to protect and taxes to save.

Choosing the Right Option

Buying a life insurance policy can be an intimidating experience, which is the main reason why people procrastinate. Armed with the fundamental knowledge about your own needs, the different types of policies and how the process works, you should be able to enter the process in control and with greater assurance that your life insurance needs will be met.

With so much at stake for you and your family, it doesn't make sense to simply guess at the amount of life insurance they will need. Simple formulas, such as a multiple of annual earnings, are likely to fall short of the actual need. It's also not very comforting if you feel you own too much life insurance. By taking a little extra time up front, you can arrive at an amount that you and your family know will provide the right amount of financial security. Several factors need to be considered:

- current assets and current liabilities
- earning capabilities of the surviving spouse
- income available from other sources
- future income needs of dependents at all stages of life
- important family obligations such as college education
- protection of a family owned business

Your financial advisor can provide you with a no obligation analysis which can crunch the numbers based on a few different scenarios and help you determine what protection option makes the most sense for you. If you don't have a life insurance protection plan in place or you haven't reviewed your coverage recently in relation to your current life circumstances, contact us today. Life By Design Investment Advisory Services can help you take the first step in getting the coverage you need with minimal time investment on your part.

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