Pay To The MAX Minimize The TAX

When Overfunding Your Life Insurance Policy Makes Sense

BY JOHN A. RUGGIERO

We get calls daily from producers who ask us for a spreadsheet with an array of carriers illustrating the "cheapest premium possible." Now, I'm not talking about term insurance, which is a product that is strictly based on price. No, I'm talking about universal or equity indexed life products.

It occurred to me that somewhere we have missed one of the most important aspects of permanent insurance, which is its ability to accumulate significant cash on a tax-favored basis, which we have failed to communicate this to our prospects.

Additionally, throughout my career I have educated my clients through a five-minute lesson that changed their thinking about putting the minimum possible premium into permanent life insurance. Let me share it with you.

On a blank sheet of paper, I draw two horizontal lines, one at the top, which I label "Maximum Premium," and one at the bottom of the page, which I label "Minimum Premium."

I then ask the prospect, "Who do you think determines the amount of the minimum premium?"

The answer: "The insurance carrier." Their actuaries determine the minimum amount of premium necessary to keep an amount of insurance in force to an age of 120.

Then I ask, "Who do you think determines the maximum premium you're able to invest into a life insurance policy?"

The answer: "The U.S. government." I ask, "Why do you think the U.S. government would be remotely interested in the amount of premium you're able to invest in your personal life insurance policy as it relates to taxes? Because the government knows that life insurance is a good, tax-advantaged vehicle, which is why they limit the amount of premium you're able to deposit into it."

I then begin to explain the benefits they will receive when they deposit premium above the minimum premium, up to the maximum, modified endowment contract (MEC) limits, such as:

Tax Deferral: One of the chief advantages of using permanent whole life insurance is the tax-deferred

growth of cash values. With business life insurance, policy cash values can be listed as assets on the company balance sheet and can be accessed for use by the company at any time. The tax deferral of cash growth makes life insurance an ideal vehicle for funding executive compensation plans, creating supplemental retirement income for business owners or funding a corporate stock redemption plan.

Tax-Free Distributions: Another tax advantage found in whole life or universal life insurance policies is that cash values may be accessed by the company tax free. If structured properly, policy withdrawals and loans can be used to essentially eliminate taxes on cash received from a life insurance policy.

Competitive Internal Rate of Return: These policies can be an appropriate, even an excellent investment because of the lack of federal taxation on the internal earnings of the policies. And if they are held until death, no tax is ever paid on these earnings.

Guarantees: Insurance carriers have come up with a solution to guarantee the insurance benefit on a universal life insurance policy even if the cash value in the policy goes to zero. This is known as a "secondary guarantee." You agree to pay a premium that is often less than a whole life insurance premium, and if you keep your payments up, the policy's death benefit is now guaranteed.

Creditor Protection: The simplest form of asset protection planning involves the ownership of "exempt" property that state law considers unreachable by creditors. Certain property, such as a primary residence, may be entirely exempt, while the exemption for other property may be limited to a certain dollar amount. Life insurance benefits may also be exempt property in your state.

Unlimited Contributions: The IRS allows contributions in life insurance up to the MEC limits.

Collateral: It is very common to designate a policy's death benefit or its cash surrender value to a creditor as security for a loan. If the loan is not repaid, the creditor receives the policy proceeds up to the balance of the outstanding loan, and the beneficiary receives the remainder. Because life insurance is freely assignable, it is readily acceptable to lending institutions as security.

Freedom from Estate Tax: Generally, you don't have to pay tax on a life insurance death benefit.

Liquidity, Use and Control: The cash values and death benefits can be used in a number of ways, including:

- Funeral expenses
- Federal estate taxes, which are due within nine months of death
- State estate taxes, which are often also due within nine months of death
- Federal personal (Form 1040) and estate (Form 1041) income taxes (including taxes on pension distributions), which are due by April 15 of the following year
- State personal and estate income taxes (including taxes on pension distributions)
- Probate and administrative costs (including court filing fees and fees paid to the executor of the estate and the attorney who administers the probate)
- Payment of your debts
- Maintenance and welfare of family
- Payment of specific cash bequests
- Funds to continue operation of a family business, meet payroll and inventory costs, and recruit replacement personnel while new management is learning the business

Disability Protection: The policy's cash values can be accessed for short-term income needs when the policyholder is disabled, and if waiver of premium is added, no premiums are due when one is disabled.

> *The government knows* that life insurance is a good tax-advantage vehicle, which is why they limit the premium.

"So, Mr./Ms. Prospect, do you now see why the government is interested in limiting the amount of premium you can deposit into this life insurance contract?"

Life insurance premiums up to the MEC limits provide all these benefits with the exception of deductible premiums, but there are ways for us to help accomplish that as well.

The accumulation aspect of an insurance policy can have unique benefits. The closer you get to the MEC limit, the more the focus is on the living benefits: tax-deferred growth, tax-free distributions, competitive IRR, guarantees and creditor protection.

So, when I talk about life insurance, I am speaking about a policy that is just below the MEC limit that offers clients the benefits they are looking for in a place to park their money. They need a place to put away money that grows tax-deferred while they maintain access to that money.

"So, Mr./Ms. Prospect, now that you know this information, why would you put just the minimum into a life insurance policy?"

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