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Insurance, Taxes, and Retirement Money

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Making Life Insurance Your Financial Lifeline

Thalassophobia is the fear of deep, dark water, named for those who fear the unknown that's lurking below the water's edge. While you might not have this affliction, some will argue today's fear gripping us all is the fear of the unknown stemming from the COVID-19 pandemic.

The fear of potential COVID-19 long-haul threats that could form short and long-term disabilities for survivors brings heightened interest in insurance coverage. Most forecasts hypothesize as many as 10% of COVID-19 survivors will have some form of lasting disability.[1]

Designed for risk analysis and crisis planning, we all buy some form of insurance coverage at some point in life.

But, we shoppers are also skeptics and have historically kept insurance coverage at arm's length. COVID-19 changed our focus and attitude, making us much more open to the industry. In fact, since the pandemic hit, 58% of consumers surveyed said they feel a heightened need for life insurance[2], and 37% fear the impact that COVID-19 will have on their retirement plan.[3]

The insurance industry changed when the pandemic hit. Too many families faced illness, death, and skyrocketing health care costs—with little comfort—leaving everyone on shaky financial ground. Discussions turned to insurance coverage, with many realizing that any amount of life insurance is better than none at all.

- 45% of families changed their spending habits since the pandemic to build up savings and emergency funds
- 66% believe COVID-19 helped them better understand life insurance, and 25% have purchased a policy[4]

Life insurance brings peace of mind to the policy owner knowing that they won't burden heirs with unexpected debts when facing the death of a loved one. It's important for anyone with dependents to have a policy, but there's a multitude of reasons and products to choose from that'll fit into and benefit your long-term plans.

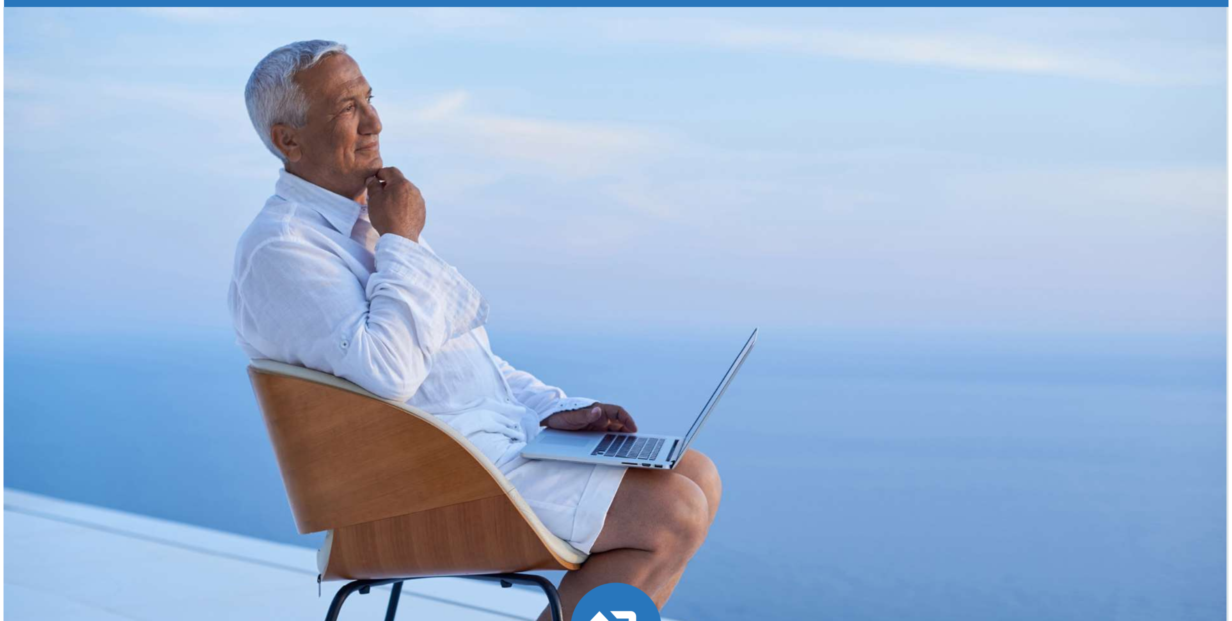
What if you decided to buy life insurance—not because of fear and not because of the death benefit—and you didn't intend to use it for risk management at all?

Life insurance policies offer tax-deferred growth, tax-free income, and liquidity as a powerful asset class. So go ahead and let life insurance fund your retirement.

What President Biden envisions,[i] isn't necessarily what will happen. Knowing this, it's still important to recognize **proposed healthcare and tax changes** and talk with your financial professional about ways to be prepared.

- Eliminate the federal poverty level income cap for tax credit eligibility and lower employees' maximum contribution for coverage to 8.5%
- Lower the Medicare eligibility age from 65 to 60 as a reflection of older Americans finding it increasingly more difficult to secure decent jobs
- Expand Obamacare so that 97% of Americans are insured and introduce a Medicare-like option available premium-free to assist those near or below poverty level
- Raise the top income tax rate back to 39.6% from 37%
- Tax capital gains and dividends at ordinary rates for those with annual incomes over $1 million
- Tax unrealized capital gains at death
- Apply Social Security payroll tax for those earning over $400,000 a year
- Close the stepped-up-in-basis loophole

[i] https://www.cnbc.com/2021/04/28/biden-wants-to-permanently-extend-enhanced-obamacare-premium-subsidies.html



Let’s Talk Tax-Deferred Money

Tax deferral happens when the cash value of your life insurance policy isn’t taxed while it’s growing. Investors only enjoy tax-deferred benefits from a few investments like IRAs and 401(k)s. Still, when they’ve maxed out their contributions, a **whole life insurance policy** is another great option.

With whole life insurance, your money isn’t reduced in value each year from taxes. As a result, it grows faster because the interest you make on your cash value is applied to a higher amount. Imagine the benefit during your retirement years. At that time in your life, you’re no longer bringing home a regular paycheck, so it’s relatively safe to assume your income will place you in a lower tax bracket. Now, if you withdraw your money when you’re in a lower tax bracket, it’ll be taxed at a lower percentage than when it was first applied to your account.

The gap between a taxable vs. tax-deferred account grows larger as the timeframe becomes longer — that's the power of tax-deferred compounding

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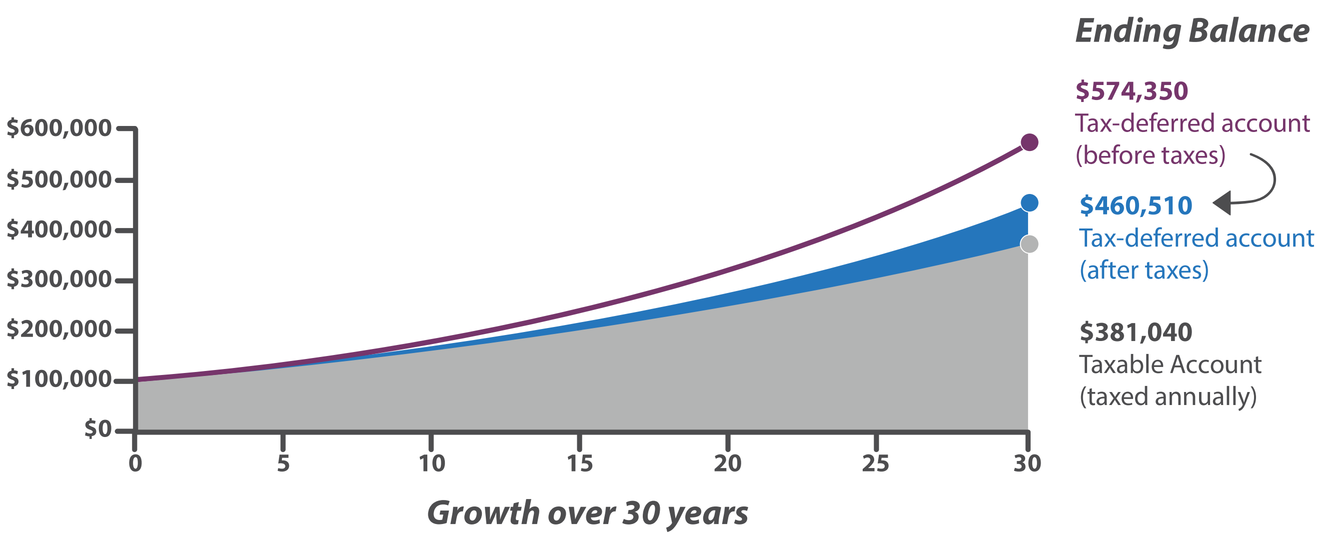

HYPOTHETICAL ASSUMPTIONS

1. $100,000 initial investment
2. 24% tax rate
3. 6% compounded annual rate of return

Source: J.P. Morgan Asset Management. Chart shows aftertax $100,000 initial account value in the beginning of year one for a tax-deferred account and a taxable account. Assumes a 6.0% annual return for both accounts. Investment returns in taxable account are taxed annually at 24% (capital gains and qualified dividends are not considered in this analysis). Tax-deferred account balance is taken as a lump sum after year 30 and taxed at 24% federal tax rate. If tax-deferred account is taken as lump sum at other tax rates, after-tax balance would be $517,430 (12%), $469,990 (22%), $422,560 (32%), $408,330 (35%), $398,840 (37%). This hypothetical illustration is not indicative of any specific investment and does not reflect the impact of fees or expenses. This chart is for illustrative purposes only. Past performance is no guarantee of future results.

It's Okay To Talk To Yourself When You Need A Loan!

Using your life insurance is another way tax-advantaged growth can help fund your life events such as college tuition, a home down payment, or unexpected large expenses.

Whole life insurance policies don't have restrictions on how much you can invest in this type of plan. Having no limits means there's a significant benefit for structuring this alternative income strategy for a loan option. If you want to access the cash value that's accumulated in your policy, you can take out loans or withdraw the money without tax consequences (as long as they're structured properly).[5]

Taking a loan from your life insurance provides access to a penalty-free loan option by using the policy as collateral and taking a tax-free loan from the cash value. A whole life insurance policy affords you, the investor, the ability to use your money when they need it most during your lifetime. Today's interest rates are so low that typical conservative assets (savings accounts, bank CDs, bonds, etc.) are earning less than the rate of inflation and certainly not growing enough to cover rising medical costs. Further, these assets are taxable at ordinary income tax rates, which means that these investments are highly inefficient without more risk. A life insurance contract as an asset grows tax-deferred and allows you to access the cash value tax-free.

If you need money to make a significant purchase or even pay for college, you can borrow against the policy's cash value and receive it free of taxes. The interest rate for repayment is generally low compared to an institution's loan or a credit card. Done correctly, a tax-free loan on life insurance can offer investors a source of liquidity and tax-free income during retirement.[6]

Now let's talk about how life insurance can supplement your retirement income!

Let's consider a fictional situation where a life insurance policy, designed to have low loads and high cash values, can be a vehicle to supplement your retirement income if appropriately managed.

Imagine you plan ahead and annually make a premium payment to the insurance company over a 20-year period. The cash value in the account grows tax-deferred. You stick to the plan and wait for the right time to flip the switch. Eventually, you reach that stage in life when your family is grown, you've left corporate America, and you no longer feel the need for a death benefit. You might also find yourself in a lower tax bracket at this point.

Now, flip the switch. Per the retirement plan you created with your trusted financial partner, you make a tax-free exchange of the policy into an immediate-payout annuity. Your investment earns a decent after-tax rate of return, and you begin receiving a monthly guaranteed payment for the remainder of your life. It's also possible that the taxes on the cash values from the past 20 years are prorated over your remaining life expectancy. Of course, if you faced an untimely death while still holding your life insurance policy, your beneficiary would receive the tax-free death benefit.

High-Net-Worth Family Wealth Transfer Across Generations

Leverage the high GST (Generation Skipping Transfer) exemption rate now as the IRS/Government is slated to move the exemption back down to $5 million in 2026

1. Estate Planning with Life Insurance

Using life insurance as the investment choice to mobilize your money works because it pays when needed and pays a benefit that is income tax-free

2. Generation 1 - Parents

Uses the $11.4 million GST Exemption to pay a one-time life insurance premium.

Sets up the life insurance policy as a dynasty trust with a $25 million death benefit.

3. Generation 2 - Children

Upon the death of generation 1, the trust collects the insurance proceeds ($25 million) tax-free.

The trust now pays interest to generation 2.

4. Generation 3 - Grandchildren

When generation 2 dies, the trust's principal goes to generation 3.

The estate wealth transfer remains intact and can begin again for future generations.

Most importantly, neither generation pays gift, estate or GST taxes!
Currently, the federal wealth transfer tax rate is 40%, and the IRS provides an $11.4 million exemption before the 40% kicks in.

https://www.forbes.com/sites/steveparrish/2019/07/09/is-life-insurance-an-investment/?sh=4a57b2532b45

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What should you expect from your financial partner as you forge ahead with deciding how best to use your insurance? Improved customer satisfaction by introducing alternative use options, intuitive planning, and upping their service game. The Impact COVID-19 made on the insurance industry will be talked about for decades. Now is the time to talk about your choices and decisions regarding overcoming your fears and changing your retirement plan—call us if you're ready.

[1]"COVID-19: Long-term Effects" Mayo Clinic. https://www.mayoclinic.org/diseases-conditions/coronavirus/in-depth/coronavirus-long-term-effects/art-20490351 [Accessed May 6, 2021]

[2]"COVID-19 Drives Consumers to Seek Hybrid Experience When Buying Lfe Insurance" LIMRA. https://www.cnbc.com/2021/04/28/biden-wants-to-permanently-extend-enhanced-obamacare-premium-subsidies.html [Accessed Oct 26 2020]

[3]"COVID-19, Consumers and Coverage: Survey shows what insurance buyers want now" PwC. https://www.pwc.com/us/en/industries/insurance/library/insurance-consumer-survey.html [Accessed June 2020]

[4]"COVID-19 is Prompting Families to Rethink Their Finances" Life Happens. https://lifehappens.org/blog/covid-19-is-prompting-families-to-rethink-their-finances/ [July 10 2020]

[5]"What are the tax benefits of whole life insurance? Guardian. https://www.guardianlife.com/life-insurance/tax-benefits [Accessed May 2021]

[6]Darla Mercado, CFP, August 19, 2018, "This source of tax-free cash can sweeten or ruin your retirement," [Online]. Available: https://www.cnbc.com/2018/08/17/this-source-of-tax-free-cash-can-sweeten-or-ruin-your-retirement.html