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DEATH BENEFIT, TAX-DEFERRED GROWTH & PART OF A WEALTH TRANSFER PLAN

Life Insurance as a Financial Asset

Your financial portfolio should do more than just seek growth—it should help protect your wealth, diversify risk, minimize your tax burden and provide a seamless transition to future generations. While investments like stocks, bonds or real estate often form the foundation of a portfolio, these strategies alone may not be enough for high-income earners looking to protect their family and ensure long-term financial stability.

One tool that is often overlooked in wealth management is cash-value life insurance, but it can be a powerful financial vehicle beyond its traditional role of providing after-death benefits. If structured properly, the cash value of a policy can be accessed on a tax-advantaged basis for any reason, such as an emergency during your working years or as a retirement income supplement. Beyond estate planning benefits, the cash value can be accessed during down markets when volatility impacts your other assets. As an example, whole life insurance (sometimes referred to as cash value life insurance) can optimize a financial strategy integrating the need for a death benefit with tax diversification of your long-term assets.

In this article, we'll dive into why people might consider cash-value life insurance as a strategic tool, explore how it can complement an investment portfolio and identify the types of people who may stand to benefit most from incorporating it into their wealth transfer plan.

I. Why Consider Life Insurance as Part of Your Overall Financial Strategy?

Permanent cash-value life insurance offers several unique features. Here are some reasons why it deserves consideration in a well-rounded wealth management strategy:

- Death Benefit: In the event of your passing, your beneficiaries will receive the death benefit proceeds from the policy. This type of coverage is permanent, meaning it will last as long as you do, provided the premiums are paid and the policy hasn't lapsed or been terminated.
- Estate Planning: For individuals with large estates, cash-value life insurance can be a key tool for transferring wealth, potentially income tax-free, to heirs without going through probate. Under IRC Section 101(a), life insurance death benefits are generally not subject to income tax. If trust-owned, these benefits are generally not subject to estate tax either.
- Tax Efficient Retirement Tool: Permanent life insurance can help protect your family while you are still working and saving for retirement. Another reason high-income or high-net-worth individuals might consider incorporating cash-value life insurance into their financial strategy is its tax-deferred growth. It provides a systematic and disciplined approach to accumulating funds. Under IRC Section 7702, the

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cash value within a life insurance policy grows tax-deferred. Any available cash value can then be accessed through tax-advantaged loans, withdrawals or partial surrenders at any time, such as during retirement, offering another source to help supplement income without triggering immediate tax consequences. This can make cash-value life insurance a potentially powerful tool for retirement planning.[1]

- Protection and Growth: For whole life insurance policies, cash value grows independently of market fluctuations, offering a predictable internal rate of return on a guaranteed basis. For those seeking growth with limited market exposure, indexed universal life (IUL) policies credit interest based on the price performance of certain market indexes such as the S&P 500, offering potential growth. Interest will be credited when the linked index's price movement is positive, subject to the participation rate and cap. IUL policies also have floors which limit loss when the linked index has a negative return.[2]
- Other Considerations: Unlike stocks or mutual funds, which can be liquidated easily, accessing the cash value from a life insurance policy typically involves loans or withdrawals that may be limited or unavailable in the early years of the policy. Withdrawals and loans will reduce the policy's death benefit, so it's important to evaluate your needs when considering how life insurance will fit into your financial strategy.

II. Cash Value Life Insurance vs. Investments

Cash value life insurance products offer unique features compared to investment products, providing a balance of growth and protection:

- Growth vs. Protection: While stocks and bonds focus on generating growth, they're not contractually guaranteed. The cash value component of life insurance grows at a steady pace, offering a level of stability that investments can't provide. Additionally, life insurance provides a layer of security with its guaranteed death benefit.[3]

III. Who May Benefit from Using Life Insurance as a Financial Asset?

While life insurance offers benefits beyond distribution to your heirs in the event you pass away, it's most advantageous for a specific type of person: those who can afford the premiums and are young and healthy enough to secure favorable rates. Those who are looking for a tax-advantaged asset that can help secure future benefits and protect their family may want to consider this approach.

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[1] Please note that access to cash values through borrowing, withdrawals or partial surrenders will reduce the policy's cash value and death benefit, increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured. If the policy is a Modified Endowment Contract, policy loans and/or distributions are taxable to the extent of the gain and are subject to a 10% tax penalty if the policyowner is under age 59 1/2.

[2] Returns for this type of policy will vary based on the performance of the index and it is possible for the policy account value to decline due to deduction of policy charges. Floor, cap and participation rates can be adjusted by the issuer and are not guaranteed.

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Who isn't a great fit? Individuals without sufficient disposable income -- life insurance may not be a practical option because, for the beginning years, it requires ongoing premium payments. And for older individuals, the cost of the policy may outweigh the benefits.

The decision to purchase life insurance should be based on long-term financial goals and the need for a death benefit. Life insurance is not an appropriate vehicle for short-term savings or short-term investment strategies. While a policy can allow for loans, you should know that there may be little to no cash value available for loans in the policy's early years.

IV. Conclusion: A Strategic Tool

Life insurance can be used as a strategic asset to bring an additional layer of tax efficiency, risk mitigation and wealth preservation to your financial strategy. However, it is not a one-size-fits-all solution. Those considering life insurance need to evaluate their financial situation, goals and long-term outlook to determine if it is the right fit for their financial strategy.

If you're interested in learning about life insurance and other more nuanced ways to enhance your financial strategy, we're here to guide you through the options.

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