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Got Life Insurance?

Here's how most people probably approach life insurance: It's something they realize they might need, but they don't like thinking about it too much. So they buy a policy that fits their budget, stick it in a drawer, and hope they never have to think about it again. Life insurance has a reputation for being a boring subject that no one wants to talk about. But for families who experience tragedy, life insurance can serve as a beacon during a very dark time.

If your family has a need for life insurance, it's critical that you obtain the appropriate type of policy and coverage amount for your situation. After all, if you are going to the trouble of buying insurance, your family will be glad you had the necessary protection if they ever need it.

Purchase the right type of policy. Most life insurance policies fall into one of two categories. *Term life insurance* is a temporary policy that remains in force for a set number of years. If the policy expires before you do, your heirs receive nothing upon your death. This type of policy does not accumulate cash value and the insurance company keeps all premiums you paid during the term.

Term insurance is a popular choice for young families because it can offer a substantial death benefit at a fairly inexpensive cost. However, term policies become more expensive as the insured ages and may eventually become too costly to renew.

Cash-value life insurance, also called *permanent* insurance, remains in force throughout your lifetime, as long as premiums are kept current. When you buy a permanent life insurance policy and begin making payments, the policy has the potential to accumulate cash value on a tax-deferred basis. Eventually, you may be able to withdraw any cash value up to your cost basis in the policy, which is the amount of premiums paid, without incurring any income tax liability.

When your cost basis has been withdrawn, you may be able to borrow against the death benefit. Because loans are not usually considered to be income, you typically will not incur any income tax liability. However, the amount of any outstanding loans plus any interest will be deducted from the death benefit after the insured has died.

Permanent insurance may seem like the easy choice, but it is usually more expensive than term insurance, particularly in the early years. This type of policy is popular among people who expect to owe estate taxes or want to leave a legacy for their heirs or a charitable cause. A permanent life insurance policy is also appropriate for people who are attracted to the idea of potential access to the accumulated cash value during their lifetimes for retirement income, college funding, or other major financial goals.

Own the policy correctly. Your beneficiaries will not owe income taxes on the death benefit from your life insurance policy. But if you own your life insurance policy anytime during the three years prior to your death, the death benefit will be considered part of your estate and could contribute to a potential estate tax liability.

If you don't believe your estate will be subject to estate taxes, here are two possibilities that you should consider:

- If your policy will pay a large death benefit, it could raise the value of your estate enough to trigger estate taxes.
- If you don't expect to die for several years, don't discount the possibility that your estate could grow large enough during your lifetime to trigger estate taxes.

By setting up a properly structured irrevocable life insurance trust to own your life insurance policy, the death benefit will not be considered part of your estate. You fund the trust by making "present interest gifts" of cash each year to the trust, which uses the money to pay the premiums.

Get enough coverage. Forty-four percent of U.S. households either don't own life insurance and believe they should, or own life insurance but think they need more. Among those who own life insurance, 40% believe they don't have enough.¹ And they are probably right.

Experts recommend a variety of methods to estimate how much life insurance your family might need. But the best method might be a good old-fashioned gut check. Ask yourself some tough questions about how much money the surviving spouse would need if a breadwinner in the family suddenly died:

- How much money would the surviving spouse need to pay the mortgage and avoid having to sell the family home and move to a smaller residence?
- How would the surviving spouse care for the children while continuing to work?
- How will the kids pay for college?

- How will the surviving spouse's retirement program be affected? Will he or she be able to continue setting aside enough money to pay for a comfortable retirement?

Conduct a regular review. Once you have the appropriate coverage in place, it's wise to review your policy (or policies) on a regular basis. Here are some of the things you will want to review:

- Have there been changes in the family that would require additional coverage?
- Has the mortgage payment gone up?
- Is either wage earner earning more money that would not be replaced by the existing death benefit? Has the family's need for income increased since the policy was purchased?
- How has inflation reduced the spending power of the death benefit from a policy that may have purchased several years ago?
- Are the primary and secondary beneficiaries properly named?

Purchasing the correct type of policy and the proper amount of coverage involves many factors, some more complex than others. Please call if you would like to review the role that life insurance can play in your financial situation.

The cost and availability of life insurance depend on such factors as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable by having the policy approved. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications.

The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional before implementing such strategies.

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1) LIMRA International, 2005