Here's why cash value life insurance is a superior product

FEB 26, 2015 | BY RUSSELL E. TOWERS, J.D., CLU, CHFC

The product's tax, legal and financial advantages make it an asset that should be a component of virtually every client portfolio.

Whether your client has estate planning needs, business protection needs, or supplementary retirement needs, **cash value life insurance** offers great competitive advantages versus alternative financial assets. These advantages fall into three major categories: 1) Tax advantages 2) Financial and actuarial advantages and 3) Legal and contractual advantages. These inherent advantages make cash value life insurance a financial asset that should be an important component of virtually every asset portfolio mix.

What about **term life insurance**? Certainly term insurance has a place in many planning scenarios where protection needs might terminate after a fixed period of time. However, because of its actuarial design, term insurance cannot offer the major advantages offered by cash value permanent insurance. Term insurance ends after a fixed number of years and only pays a death benefit if the insured dies while the policy is still in force. And term insurance is designed to terminate before the usual **life expectancy of most individuals**. This can create a problem if your client still has certain asset protection or asset accumulation needs that will continue for the remainder of their lives.

Cash value life insurance can be designed to pay a death benefit whether your client lives to their life expectancy or not. Of course, permanent life insurance differs from carrier to carrier. Policies come in different flavors depending on your client's fact situation and risk profile. These policy types include no-lapse Universal Life (UL); Current Assumption Universal Life (CAUL); Indexed Universal Life (IUL); and Traditional Whole Life (WL). Most of these permanent types of policies offer a unique combination of features and benefits that place them in a class by themselves.

Federal tax benefits of life insurance

Listed here are a number of federal tax benefits that give a significant competitive edge to cash value life insurance versus other fixed financial assets:

- IRC Section 101(a) provides that death benefits of life insurance are generally income tax free when paid to the policy beneficiary. This is true whether the death benefit is paid to an individual, a business entity, a trust, or an estate. The death benefit can also be made estate tax free if the policy is owned by a third party (adult child) or an irrevocable trust.

- The policy can pay out tax-favored benefits to the policy owner before the death of the insured. For non-MEC policies, cash can be withdrawn from the policy tax free -- in most cases -- up to the adjusted cost basis (First in, First out- FIFO) under IRC Section 72(e)(5). Withdrawals will reduce the policy's cash value.

- The policy can pay out tax-free cash to the policy owner in the form of policy loans at a stated rate of interest. Loans will reduce the policy's cash value and may reduce the death benefit. This assumes the policy never lapses while the insured is still alive. Keep in mind that the tax free treatment of policy loans only applies if the policy is not a MEC.

- Tax-free cash value withdrawals or loans are not subject to the 3.8% passive income tax under the Affordable Care Act (ACA). Also, tax-free withdrawals or loans are not considered as income for purposes of calculating income taxes on Social Security retirement benefits. And cash value life insurance is not considered to be a countable asset on the FAFSA application for college financial aid at public colleges.

- The policy owner may receive an income tax free advance of some of the death benefit for certain long term care expanses, chronic, or terminal illness under IRC Section 7702B or IRC Section 101(g). These potential tax free benefits depend on the design of the policy which may or may not include certain long term care riders.

- Growth of policy cash values in excess of the cost basis are typically income tax deferred while they remain in the policy. However, a complete surrender of a policy in a gain position will have income taxes on the gain in excess of adjusted cost basis.

- A policy in a gain position can be exchanged tax-free directly to another insurance carrier under IRC Section 1035(a). Often, this exchange can result in an equal or greater death benefit, lower or no future premiums, or a combination of the both.

- A policy in a gain position can be exchanged tax-free to another carrier for either a deferred annuity or an immediate annuity contract under IRC Section 1035(a).

Financial and actuarial design advantages of life insurance

- Life insurance is a financial asset that is designed using the mathematical models of actuarial science. The pricing and features of life insurance are determined via present value and future value calculations over an assumed life expectancy of large numbers of deceased individuals over a long period of time.

- The policy may be structured so that death benefits have the potential to increase from year to year. Policies may be designed with different crediting methods based on no-lapse guarantees, current assumption interest crediting, crediting based on a stock index like the S&P, or dividend assumptions from certain carriers.

- Policies may utilize certain riders for term insurance, long term care, waiver of premium for disability, over-loan protection, cash value enhancement and other features

- The life insurance industry is one of the most competitive industries in the U.S. This product, pricing, and feature competition of policy design assures that U.S. consumers have a wide variety of product types, features, and carrier financial strengths to choose from based on their personal financial and protection needs.

- Often, the present value cost of life insurance at life expectancy and beyond is the lowest method of financing a family, business, or estate protection need when compared to other fixed financial assets with taxable yield like CDs, bond mutual funds, or U.S. government securities. This is especially true in this continuing low interest economic environment.

Legal and contractual advantages of life insurance

- Life insurance is a legal contract between the policy owner and the insurance company. Any guarantees specified in the contract are legally enforceable under state law protections of all the states.

- Insurers are heavily regulated in all 50 states and are required to reserve significant assets to pay future death claims.

- The life insurance industry has established state “guarantee funds” to pay valid claims under policies issued by any carrier that are insolvent or in receivership. Insolvent life insurance carriers are an extremely rare event. Prospective purchasers of life insurance should ask for the current Comdex Financial Strength rating of each carrier with which they propose to do business. This Comdex value is a composite number based on Moody's, Standard & Poor's, A.M. Best, and Fitch rating agencies.

- Many states have adopted statutory law that protects policy cash values and death benefits from the claims of the policy owner's creditors.

- Policy owners have the contractual right to assign the ownership of the policy to a new owner; the right to change the beneficiary of the policy to a new beneficiary; the right to collaterally assign the policy to offset a debt obligation to a financial institution or other legal person; the right to take a reduced paid-up policy where no more future premiums are due.

The financial security of your clients can be enhanced dramatically with the unique financial asset of cash value life insurance. However, unlike other financial assets, its purchase is not an automatic transaction. Life insurance companies have underwriting rules and guidelines to gather and evaluate the proposed insured's medical and financial situation. If these underwriting requirements are successfully met, a policy will be issued to the policy owner in upon payment of the premium.