

# Traditional Life Insurance in a Qualified Plan

John Jones, a dentist age 40 with an income of \$150,000 per year dies in an auto accident leaving a wife and two children and no life insurance. (Accidents were a cause of 112,012 deaths in 2003-2004.\*)

Charles Day, age 50 a businessman with a company that has \$3,000,000 in sales dies from cancer leaving 15 employees. No Life Insurance, Charles draws a \$175,000 salary from the company. (Cancer (malignant neoplasm) was responsible for 553,888 deaths in 2003-2004.\* )

Dr. Mahdion, a specialist in oncology, earning \$500,000 a year age 55 dies, with a heart attack having no Life insurance. (Heart disease was responsible for 642,482 deaths in 2003-2004.\*)

***All of these people had purchased life insurance at some point in their lives and the term policies expired before their deaths. In some cases, the insurability of the person had changed, and in others they were too busy to renew their policy. What is the economic impact of not carrying life insurance?***

## Financial Analysis

John Jones's \$150,000 income at age 40 would require approximately \$2,448,100. This is based upon a single life annuity using current interest rates with no refunds to the survivor. John may not believe in Life insurance and have no coverage whatsoever. John's widow and children see it differently.

Charles's income, if it were to be replaced, would need approximately \$3,000,000 in death benefits. Charles had a term policy, but his health had changed and was no longer insurable and the term policy had lapsed.

Dr. Madion's \$500,000 income would take nearly \$10,000,000.00 in death benefits. Unfortunately due to his unexpected death, the income stream is lost forever.

## Life Insurance Policies

*Most people in the U.S. carry no insurance at all. A recent survey showed 42% of all Americans with no Life Insurance at all. Many who do carry insurance carry term policies or Universal Life. Why would anyone carry Whole Life?*

## Renting vs. Buying – House or Insurance

### The House

*The best analogy is the difference between renting and buying a home. In the short term, 3-5 years, generally you would be better off to rent a house than to purchase a home. If you factor into the closing cost, commissions, mortgage fees, down payment etc. The initial purchase of the home is very expensive. However, generally if you look at the appreciation over 10 or 15 year period, the purchase of the home can become a wise investment. The tax advantages of the mortgage interests deduction and the ability to sell or exchange the home tax free in many cases makes the home a great tax shelter.*

### The Life Insurance Policy

*The same issues are involved with Whole Life Insurance. The initial acquisition of the policy may be larger premiums, lower cash values in the early 3-5 years. When you look at the policy values 10-15 years, in many cases the policyholder is in for a pleasant surprise. Tax-free build up, tax-free distributions, tax-free exchanges all take place within the policy. Guaranteed death benefits, guaranteed cash value build up and guaranteed non-forfeiture rights can make a policy an asset of any estate. In some cases, the policy can be sold for a percentage of the death benefit otherwise known as a viatical settlement.*

Can you purchase the policy on a tax deductible basis? Generally the answer is no. If you set up a qualified plan such as a 412(i) plan the answer then is YES.

## Run the Numbers

### Term:

Charles' 20 year term policy would cost \$7500 per year for \$3,000,000 in death benefits. At the end of 20 years, Charles would have spent \$150,000 and have no death benefit, no coverage. To continue another 20 year term would cost \$52,000 per year.

### Whole Life:

In a Whole Life Policy, the policy builds up cash value as well as maintains a death benefit. The contribution is usually 10 times more than the term cost. In the instant case the Whole Life contribution was \$81,000. Based upon current interest rates and current mortality cost, the total contribution is \$1,296,000 over 20 years. The cash value is \$1,379,000. Charles' financial gain is \$83,000. Charles also continues the \$3,000,000.00 coverage. If the policy was purchased by a 412(i) defined benefit plan, the contributions of \$1,296,000 would have been tax deductible saving an additional \$453,600 in Federal Income Taxes.\*\*

### Term vs. Whole Life:

Term guarantees a loss of \$150,000.

The whole life product may produce a gain of \$83,000.

The Tax savings if the policy is purchased in a qualified plan would be \$453,600\*\*

This creates a financial differential of \$686,600\*\*\*

\*These are the statistics from the CDC National Center for Health Statistics.

\*\* Based upon a 35% Federal Tax rate.

\*\*\* (The gain is based upon current interest and mortality cost. If there is an improvement in interest rates or mortality the gain may be greater, if there is an increase in mortality and interest rates decline, the gain may be less.)

What is better? It depends on your situation. You should consult your Insurance or Financial Advisor as to which would be the best policy for you.

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Phone: (360) 756-0776 Fax: (360) 756-9033 | 4164 Meridian Street, Suite #400 Bellingham, WA 98226 | <http://www.ebdgonline.com>  
East Coast: 1-800-303-3480 | 1200 G Street, NW, Suite #800 Washington, District of Columbia 20005

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