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WEALTH STRATEGIES & INSURANCE SOLUTIONS, INC.

Supplemental Life Insurance for Retirement Planning

Overview

Supplemental life insurance for retirement planning ("SLIRP") uses a life insurance policy structured to generate a tax-deferred cash flow during retirement. This technique may be extremely useful for those wishing to explore additional options to supplement traditional retirement income sources. Note, however, that all life insurance decisions should be made with a view toward death benefit protection needs.

Description of Technique

Premiums are paid into a permanent life insurance policy with the intent to provide a death benefit as well as cash value accumulation for as long as the policy remains in force. At the time when retirement funds are needed, cash surrender values can be withdrawn income tax-free up to the owner's cost basis in the policy as long as the policy is not classified as a modified endowment contract. Cost basis is generally the total premiums paid. When withdrawals exceed cost basis, the owner might choose to take loans against the cash surrender value, with interest calculated at the current rate. Interest which is not paid would be added to the outstanding loan amount. In the event of the insured's death, any outstanding loan and interest would reduce the total death benefit received by the policy beneficiary.

The extent to which cash value may be accessed depends on the type of permanent life insurance policy. The owner of a whole life policy may surrender paid up additions and take loans against the policy's cash value. In the case of universal life and variable universal life policies, an owner may make withdrawals in addition to taking loans against cash value. Withdrawals would also reduce the total death benefit of the policy.

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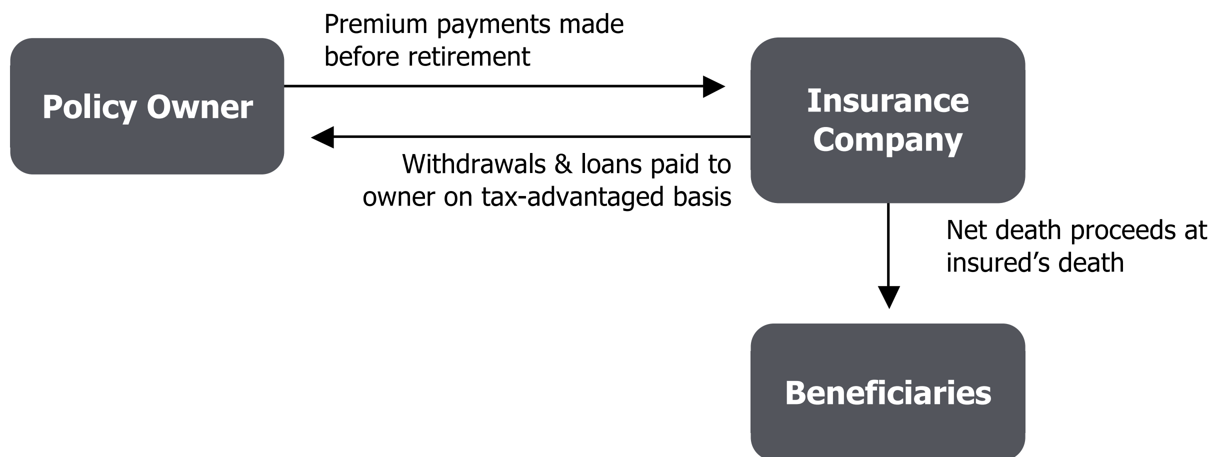

Tax Implications

Income Tax Considerations

As described above, withdrawals up to the owner's basis in the policy are generally received income tax free. Loans taken against policy cash value are also not income taxable as long as the policy is kept in force. Loan interest must be paid or accrued at the current rate.

If the policy lapses or is surrendered during the insured's life, income tax would be due on any gain in the policy. If a policy loan is outstanding at the time of death, the distribution of the death proceeds will be reduced by the amount of the outstanding loan. In general, the use of the death proceeds to repay a policy loan does not cause the recognition of taxable income with respect to the policy's death proceeds.

The 3.8% Medicare surtax does not apply to cash value withdrawals (as long as the policy is not a Modified Endowment Contract). Beginning January 1, 2013, the surtax is imposed on the lesser of a taxpayer's (i) net investment income and (ii) the excess of modified adjusted gross income over $200,000 for single taxpayers and $250,000 for married taxpayers filing jointly. In addition, lifetime access to policy cash value is not added to adjusted gross income in determining whether Social Security benefits are subject to income tax as well as the increase in certain Medicare premiums (in contrast, tax-free municipal bond income is included in the calculation).

The American Taxpayer Relief Act of 2012 increased the tax rates for capital gains and dividends from 15% to 20% for married couples with income over $450,000 as adjusted for inflation ($464,850 in 2015). The tax-deferred inside build-up of insurance cash value as well as the tax-advantaged access described above could assist high income earners in mitigating the potential impact of these higher tax rates.

Gift and Estate Tax Considerations

Gift Tax: If the policy is owned outright, the payment of premiums would not be considered a gift. If however, the policy is owned by an irrevocable trust, annual gifts to the trust to enable the trustee to pay premiums may use a portion of the owner's gift tax exemptions or trigger gift tax.

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Estate Tax: If the policy is owned outright, upon the death of the insured, proceeds would be included in the owner's taxable estate. To avoid inclusion of proceeds in the taxable estate, the owner might consider having an irrevocable trust own the policy. Cash value could be accessed through spousal access provisions, loans from the trust, or funding policy premiums through a split dollar arrangement.

Advantages of the SLIRP Technique

As compared to a qualified plan:

- The policy can provide retirement income without excessive administrative costs or government reporting.
- Annual contribution, vesting and participation limits do not apply.
- Cash value is available for an individual's needs without being subject to penalties for early withdrawals.
- Insurance policy death benefit can be removed from the taxable estate.

Additional Benefits of using Life Insurance to Supplement Retirement Planning:

- The arrangement is flexible and can be tailored to fit the needs of the individual.
- Cash surrender values grow on a tax-deferred basis and can be withdrawn income tax-free.
- Death benefit is generally received income tax-free by the policy beneficiary.
- The policy can be pledged as collateral for a loan.
- Asset protection laws of the owner's state may protect life insurance cash values and death benefit from claims of creditors.

Roth IRA Limitations

Flexibility and features of a cash value policy may serve as an effective alternative to a Roth IRA:

- Income limitations may preclude an individual from contributing to a Roth IRA (contributions are phased out for married couples with adjusted gross income exceeding 183,000 in 2015).
- Roth IRA annual contributions are limited to $5,500 in 2014 ($6,500 for individuals over 50).

* *Issuance of life insurance is subject to underwriting. The primary purpose for purchasing life insurance is to obtain death benefit protection. You must have an insurable need to purchase life insurance and timely pay all required premiums to avoid a possible policy lapse and loss of coverage.*

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