# Why Have Life Insurance in a Qualified Plan?

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**Premiums are Tax-Deductible**: All plan contributions, including the portion allocated to life insurance premiums, are income tax-deductible.

Example: Assume the client resides in a state where the combined federal and state income tax is 42% and life insurance premium is $100,000.

| Owning the life insurance outside the pension plan: | |
|---|---|
| One must earn this amount: | $172,413 |
| Pay tax at 42%: | (72,413) |
| Amount Remaining to Pay Premium: | $100,000 |
| **Owning the policy inside the pension plan:** | |
| Premium payment: | $100,000 |
| Tax Savings (Deduction): | (42,000) |
| Net Cost: | $58,000 |

$58,000/172,413 = 33.6%

In other words, it costs one-third the amount to buy the policy INSIDE the pension plan or $114,413 less than the cost to own it outside the plan when you take into consideration the tax aspects!

Your client probably has better things to do with the $114,413, don't you think?

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**<u>Policy Proceeds Pass Income Tax-Free to the Beneficiary:</u>**
Life insurance proceeds pass to a beneficiary income tax-free to the extent they exceed the policy's cash surrender value (IRC 101).

**<u>Policy Proceeds Pass Estate Tax-Free when Paid to Spouse:</u>**
Since ERTA '80 no estate tax is due when paid to a spouse due to the unlimited marital deduction.

**<u>Plan Self-Completing:</u>** If one dies before retirement, the life insurance policy will provide all, or substantially all, the monies that would have been available at retirement.

**<u>Ratings are Deductible:</u>** The ratings applied, if any, become tax deductible as a normal part of the premium.

**<u>Larger Deduction:</u>** The life insurance is an ancillary, or extra benefit, and has the effect of creating additional tax-deductible contributions. Your client has life insurance, why not add it to the plan and create an additional deduction?

## Why Have Life Insurance in a Qualified Plan?

**Asset Protection:** The assets in an ERISA plan are protected from the claims of judgment creditors. This extends to the life insurance policy.

**Reduces Personal Expenses:** The pension plan pays the premium, the participant saves the expense, as it relieves them from the burden of purchasing personal insurance coverage.

**Lapse Avoidance:** The plan assets and contributions are used to pay the premium.

**Fringe Benefit:** Employee participants actually get two benefits: the retirement benefit and the life insurance benefit.

**Affordability after Retirement:** The participant can take the policy with them at retirement. This policy, having been issued at a younger age, will have a lower cost than a currently issued policy. The rate classification at issue will be preserved allowing the policy to be maintained at more favorable prices if the participant has since suffered a health decline.

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## Qualified Plan Exit Strategies

What happens if you need to remove the life insurance from the plan? There are several options:

- **Take a Taxable Distribution**

The life insurance policy is distributed to the participant (you) directly from the pension plan and you continue to maintain the policy on a non-qualified basis. At the time of the distribution income tax is due on the fair market value of the policy less the accumulated one year term (P.S. 58) costs.

- **Purchase the Policy**

The life insurance policy is purchased for its fair market value. The assets of the plan are not depleted; the insurance is maintained outside of the plan unchanged. This purchase is not a taxable event.

- **Exchange the Policy**

Several carriers have an exchange option feature allowing the policy inside the plan to be exchanged for a new policy outside the plan. Your insurability will remain the same as

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- **Transfer to Insurance Trust (ILIT)**

An irrevocable life insurance trust is created. The trust purchases the policy from the pension plan. The dollars used to purchase the policy roll over to your IRA while the policy itself transfers to the insurance trust. Properly structured the policy proceeds will be income and estate tax free.

- **Surrender the Policy**

If you no longer need or desire life insurance protection, you may surrender the life insurance contract and retain the cash surrender values inside your retirement account.

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