

The 5 Best Arguments for Life Insurance (Besides the Death Benefit)

In this relatively new classic article, which originally ran on Feb. 5, 2016, Ed Slott goes beyond listing great uses for life insurance and talks about the reasons why life insurance can be such a useful, flexible tool.

I do not sell life insurance. I am a [tax advisor](#). And as a tax advisor, I can tell you that the single biggest benefit in the federal tax code is the income tax exemption for life insurance.

[Life insurance](#) should be a bedrock of any serious financial, retirement or estate plan, but it is not used nearly enough, even by those advisors who do sell life insurance. For planning purposes here, I refer only to permanent insurance, not term insurance.

Obviously, life insurance provides an income tax-free death benefit and people understand that. But besides the death benefit, here are THE five best points for encouraging more people to have life insurance to enhance their long-term financial security.

1. IRAs are bad assets; life insurance is a good asset.

Most people have their retirement savings in IRAs and 401(k)s. These are bad assets because they are tax-deferred. The tax will one day have to be paid, creating a growing debt on these retirement savings. The future tax will be paid when the money is needed most, in retirement, and at an unknown, but probably higher tax rate.

This makes these traditional retirement accounts an uncertain and diminishing asset over time. Replacing these accounts over time with permanent life insurance turns these tax-deferred funds into tax-free savings. Clients should begin a program of systematic IRA withdrawals to decrease their IRA balances and plow those funds into permanent life insurance.

This tax will have to be paid anyway beginning at age 70 ½ and probably at a higher rate on a higher balance. So it's best to deal with this now to have more retirement funds available long-term. The increasing and uncertain tax debt is paid off by paying the tax now at known tax rates, which are at historic lows right now, while income tax-free savings are growing in the permanent insurance policy.

2. Life insurance is an investment, not an expense.

People will say life insurance costs too much. Moving funds either from IRAs or from other accounts to permanent life insurance is not an expense; it's an investment in a better long-term asset. Yes, if the funds are withdrawn from an IRA, there will be a tax to pay, but that tax will have had to be paid at some point anyway, probably at higher tax rates in the future.

Once the funds are in a permanent life insurance policy, they are simply located in a different and far better long-term asset than an IRA or 401(k). The funds in that new location, the life insurance policy, remove not only the tax risk, but can also eliminate the stock market risk, depending on how the policy is set up.

That's a big deal in retirement, and something you generally cannot do in a traditional IRA. If you were changing investments, you would not think of that as an expense, so the same applies here.

3. Life insurance has lifetime benefits.

People think of life insurance for the death benefit, but most people don't know about the powerful lifetime retirement and tax benefits. Funds in a permanent life insurance policy can double as a retirement savings account, but without the worry about what future tax rates will be.

If these funds are needed in retirement they are accessible, tax- and penalty-free. That is a big deal, because if the funds were in an IRA, distributions would not only be taxable (in a traditional IRA), but that increased income could trigger other so called "stealth taxes."

These are hidden tax increases in the form of phased-out deductions, tax credits, exemptions and other benefits as income increases. For example, an income increase from an IRA distribution could cause more Social Security benefits to be taxable or the trigger the 3.8 percent additional tax on net investment income from capital gains, interest and dividends.

Accessing funds from a life insurance policy are tax-free (up to cost-basis; and thereafter if taken as policy loans against the tax-free death benefit) so they don't increase income. And in fact, the withdrawals keep taxable income and taxes lower in retirement. These are valuable lifetime benefits, in addition to the death benefit.

4. You get more control with life insurance.

IRAs are subject to annual required minimum distributions (RMDs) after age 70 ½, whether the money is needed or not (Roth IRAs are exempt from lifetime RMDs). This causes forced distributions and additional taxes, though the client may not need or want to withdraw those funds.

These forced withdrawals take control away, while withdrawing from the value in a life insurance policy can be done at any time, or not. Clients are in control of their retirement savings in a life insurance policy.

5. Leverage is a powerful tool for wealth creation.

Life insurance creates more long-term wealth than any other investment. And because this wealth is income tax-free, it is much more valuable than tax-deferred retirement savings that are at the mercy of future higher tax rates.

It's the leverage that creates the wealth. Life insurance is the only investment where one dollar can do the work of many and the result is guaranteed and tax-free. With an IRA for example, it would take many years to multiply that balance; and when it is withdrawn, it will be diminished by taxes.

Taking the same funds that were in an IRA and investing them (after-the tax was paid on the IRA distribution) in a permanent life insurance policy, would produce many multiples of that original IRA balance, and it would be tax-free, not only for use during life but especially if there were an early death.

These are only five conversations, but they need to be had so that people can better understand the power and security of an investment in permanent life insurance, for life and beyond.