Beyond the Numbers

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Employing a life insurance policy for accumulation and later distribution has been popular for many years for a variety of reasons, including:

- Funds grow tax deferred
- Cost basis can be withdrawn first in, first out (FIFO), thus not incurring current income tax
- Once withdrawals reach cost basis, money can be accessed via policy loans, also without incurring current income tax
- Assuming the policy is in force when the insured dies, there are no income taxes due on the amount distributed over cost basis and the death benefit is paid income tax free (though the death benefit is usually reduced by the amount of withdrawals and loans)

On paper, the concept is very attractive. However, executing the idea presents many challenges for the policy owner as the responsibility for making appropriate deposits, managing the policy, calculating the proper amount for withdrawals/loans, and maintaining the coverage until death can be extremely cumbersome, particularly for the lay consumer. A simple error can translate to a disastrous tax situation.

One of the greatest concerns is that most strategies propose making deposits for many years and then taking withdrawals many years (often 20 or more) down the road. Who will assist your client to be sure appropriate decisions are made during accumulation, when taking distributions and the years beyond?

- A 50 year old advisor could easily be retired or unavailable for other reasons
- In my experience, carrier employed policy owner service representatives generally don't possess the knowledge or understanding to provide the needed help
- Your clients' attorney or accountant is probably unfamiliar with the product and unable to provide guidance
- Most carriers require new paperwork for every policy change, including policy withdrawals and loans. That means your client may be required to complete 12 forms per year for monthly distributions. Your client will also need to recalculate the distribution amount monthly in case it needs to be adjusted due to policy performance

I am aware of one life insurance carrier that offers comprehensive services that will:

- Automate income – one form, one time
- Automate the switch from death benefit option 2 to death benefit option 1 (a technique used to enhance policy performance)
- Automate the switch from withdrawals to loans – to the penny
- Automatically provide over-loan protection

These services will alleviate the policy management process headache. When considering using life insurance for accumulation/distribution, one must look beyond the numbers and consider how the mechanics will be managed in order to provide the greatest service to their clients now, and in the future.

Helpful Tip

Before recommending a plan, gain a thorough understanding of the process needed to (1) properly manage policy performance, (2) change death benefit options (if needed), (3) calculate and make withdrawals to basis, (4) calculate and take loans without jeopardizing the policy and (5) implement the provisions of the carrier's over-loan protection rider (a must for plans used for accumulation and distribution).