Why the Wealthy Should Buy Lots of Life Insurance

BY **BARBARA A. FRIEDBERG** | Updated Aug 15, 2019

An outgrowth of having great wealth is a desire to keep as much as possible in the family, and pass along assets to future generations. Life insurance is a popular way for the wealthy to maximize their after-tax affluence and have more money to pass on to heirs. Here's how and why insurance helps.

Tax law grants life insurance premiums and proceeds tax benefits and allows the rich a way to protect assets. The proceeds of life insurance are tax-free to the beneficiary. Wealthy people don't want their deaths to be financial thicket for heirs, so the death benefit is a big component of any life insurance strategy. But there are additional advantages to life insurance.

Policy owners with estates of $11.4 million or less (or $22.8 million for couples) can leave this amount to their beneficiaries without having to pay estate tax, as these are the limits in 2019, as per the IRS. But what about individuals or couples with estates worth more than the limits? The proceeds of a large life insurance policy can be used by the heirs to pay a tax bill for those wealthy individuals whose estate surpasses the estate tax exempt threshold.

KEY TAKEAWAYS

- Life insurance can be a useful financial tool for business owners.
- It is legal to own several whole life insurance policies.
- Life insurance policies are not counted as part of an estate and they are not taxed by the federal government.
- A life insurance policy can be sold for its cash value.

of the estate and won't be taxed. To look at the insurance premium another way, the after-tax value of the $500,000 is $300,000, thus for $200,000 ($500,000 premium amount - $300,000 estate tax), the family receives a $2 million guaranteed life insurance payout. That's a guaranteed return on the premium payment.

Important: A death benefit is a tax-free asset that can be passed onto beneficiaries.

Biz Owners Should Definitely Have It

If an entrepreneur co-owns a business, life insurance can fund a buy/sell agreement in the event of an owner's sudden death. A family business will benefit from a key person insurance policy. This is insurance on the main person in a small business, usually the owner, founder or key employees.

This policy protects the firm from going under in the event that key personnel pass on before a replacement is in place. An added benefit for these types of insurance policies is that the premiums are usually deductible as a business expense.

Life Insurance as an Asset

Life insurance is more than a death benefit. Depending upon the type of insurance, it may have a cash or intrinsic value. Thus, when the insurance is no longer needed, it can be sold as a life settlement.

Whole life insurance, properly structured, can offer steady tax-free dividends. Although not guaranteed, many insurance companies have been around for up to a century. The cash value in the policy also builds up and can be used as your own private bank for a variety of income-producing activities.

Finally, with whole life insurance, your death benefit is guaranteed regardless of your future health. This is important long-term security for the policy owner's family and heirs.

Life Insurance Strategies

There are a variety of insurance scenarios to choose. The right one may depend on, say, how your current retirement fund gets taxed. Consider these three examples:

income and, next, with an estate tax. James has $900,000 in his IRA. To avoid losing a large percent of his IRA to Uncle Sam upon his death, James buys a second-to-die insurance policy with his $900,000. Upon James' death, his wife receives the $3 million tax-free benefit.

Transfer Current Life Insurance With Cash Surrender Value Policy to Increase Death Benefit
Kevin had a 10-year-old second-to-die insurance policy worth $850,000 with a death benefit of $1.53 million. His advisor recommended he do a tax-free insurance policy exchange. The new policy had an increased death benefit of $3.48 million and there were no out-of-pocket charges.

The Two-Step Annuity Tactic
Sarah buys an immediate joint life annuity for $1 million, which pays $43,843 annually as long as Sarah and her husband are alive. Next, Sarah uses the annual $43,843 payout to fund a $5.68 million second-to-die policy. In essence, Sarah converted $600,000, the after-tax value of the initial $1 million, into $5.68 million. Finally, both the annuity and death benefits are guaranteed.

The Bottom Line

A financial advisor is important when it comes to researching smart insurance strategies for wealthy clients. These folks have an enviable problem—managing, preserving and growing wealth. Properly structured life insurance can help them with all these goals.

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Related Terms

Second-To-Die Insurance

Second-to-die insurance is a type of life insurance on two people providing benefits to the beneficiaries only after the last surviving person dies. more

What Is Whole Life Insurance?

Whole life insurance provides coverage for the life of the insured and offers a savings component for the accumulation of cash value. more

Variable Survivorship Life Insurance

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Term Life Insurance

Waterfall Concept

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Trust-Owned Life Insurance (TOLI)

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