Life Insurance Planning

Life insurance is a valuable generational wealth-transfer tool.

By R. Matthew Pate, JD, LL.M.

Many people may be familiar with the *rags-to-riches-to-rags* wealth phenomenon. The first generation builds it, the second manages it, and the third squanders it. Fear of this phenomenon motivates many families to develop a generational wealth plan that maximizes incentives for productivity and prudent stewardship of wealth. While today's wealthy seniors are likely to die with far more assets than they'll ever need, this inheritance may be a necessary source of income for their children and grandchildren, especially considering the ever-increasing costs of fundamental expenses like higher education, homeownership, and health care. Coupled with increased spending, decreased saving, and greater longevity, scant wealth may remain to leave a legacy for future generations.

Enter Life Insurance

Well-known as a tool for financial security and future income replacement, life insurance is often perceived as unnecessary once one's children are grown. For this reason, term insurance is frequently used by growing families to ensure that they don't suffer a catastrophic loss of income should a breadwinner die.

However, a wide variety of customizable permanent insurance products are often preferred because they provide both income replacement during one's working years (through a cash value that accumulates over time) and a means for guaranteeing long-term family wealth (through its potential for lifetime coverage).

You may consider using permanent life insurance for generational wealth planning for three primary benefits: leverage, guarantees, and simplicity.

Benefit 1: Leverage

With life insurance, you pay a premium in exchange for what will likely be larger payout in the event of death. This leverage of premium dollars is intended to provide a "positive return" on outlays for the benefit of designated beneficiaries.

The expected performance of a life insurance policy should be viewed in light of desired family wealth goals and can be a complement to other investments in a financial portfolio. Fees, taxes, and risks associated with any financial products should of course always be considered.

EXAMPLE: *Brian and Sofia have saved $2 million to provide them with income in retirement. They are comfortably budgeted but concerned about preserving a meaningful portion of their nest egg to provide for the education of their many grandchildren (a sum that could approach $1 million). If they include permanent life insurance in their budget, they can ensure that the money will be available to help pay for their grandchildren's education and other family needs after they've died—regardless of their longevity.*

This may even provide them greater flexibility to spend in retirement and enjoy their golden years as they desire.

Benefit 2: Guarantees

Guarantees are key benefits of permanent life insurance. Depending on the type of insurance, guaranteed annual premiums and guaranteed death benefits can provide certainty regarding the availability and cost of coverage. And while life insurance is largely viewed as a commodity, guarantees are backed by the financial strength of the issuing carrier.

For this reason, financial stability and reputation are important to consider when choosing a life insurance provider.

EXAMPLE: *Alessandro and Melissa have decided to purchase a $500,000 life insurance policy to ensure that they could provide for their grandchildren's education. Their main goal is finding a solution where the premium will be paid in full, will never change, and the death benefit will be guaranteed. A whole life policy from a well-known and highly stable insurance company may make the most sense.*

In addition to the guaranteed return on their premiums, with a whole life policy, they also benefit from the potential of accruing dividends, which further increases the return on their premiums.

Benefit 3: Simplicity

Life insurance can offer tremendous simplicity in an otherwise complex and often confusing planning environment impacted by taxes, probate, and creditor risks.

Tax benefits

A life insurance death benefit is generally received free of any income tax by the beneficiary. Contrast this with the income tax on accumulated savings that would otherwise be left to heirs.

While life insurance proceeds are included in a taxable estate,

EXAMPLE: *John and Carrie settle on a $500,000 whole life product they can comfortably afford. They designate their three children as equal beneficiaries of the policy, with the direction to them that funds are to be used for educational costs as needed. They like the idea that they can modify the beneficiary designation in the future and that all proceeds will be paid free of income taxes and also protected from their potential creditors, depending on their state.*

They may consider using a trust in the future depending on changes in tax laws in consultation with their estate planning attorney.

the current federal estate tax exemptions ($12.92 million per person in 2023) effectively eliminate the vast majority of people from federal estate taxation. Note that some states impose a state level estate tax at lower thresholds, but trust arrangements can be employed to address this issue.

Probate avoidance

Life insurance proceeds are paid directly to the designated beneficiary of the policy, avoiding probate delays and additional legal expenses. Funds are generally paid after a simple claim form is completed and the death certificate is presented. Beneficiaries can be easily changed to reflect the insured's changing wishes. Contrast this with the difficulty in updating and properly executing a codicil to a will or other estate planning document.

Asset protection

Depending on state exemption laws, the death benefit received from an insurance policy may be exempt from potential creditor claims against the policyholder, and sometimes outstanding claims against the beneficiaries as well.

Where enhanced protection is desired for long-term wealth management, a trust established during one's life or under one's will can likewise be named as a beneficiary of a policy.

On a Final Note

Life insurance has attributes that make it a uniquely effective way to create wealth for the next generation. More fundamentally, though, permanent life insurance is a purchase one makes because even if the future cannot be known, you can ensure that family legacy goals are insulated from risks such as taxes, market fluctuations, and changes in personal health.

By providing a very predicable amount in an otherwise unpredictable world, individuals have more freedom to enjoy their wealth, liberated from concerns about the adequacy of support for loved ones.

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