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Insurance Secrets They Don't Want You to Know About

You'll be delighted by what you are about to read. The real subject, courtesy of flaws in the tax law, is tax-advantaged investment strategies—the kind of stuff they don't teach you to become a lawyer, CPA or other professional advisor.

Few people know how generous the Internal Revenue Code is to life insurance and the industry lobby—people that know the right buttons to push to make sure the tax laws stay that way. You are about to learn some of those tax laws.

Before we get to some jaw-dropping, wealth-creation strategies, let's run through the basic life-insurance concepts that turn life insurance into profitable investment strategies by taking advantage of the tax-law flaws.

Concept No. 1—The dollar amount you must earn to leave your kids/grandkids $1 million—would you believe $3 million. Here's an example of how the numbers (all rounded) are determined.

So you earn that $3 million and are in a 40 percent tax bracket (35 percent federal, plus 5 percent state). You are bludgeoned with an income-tax bill of $1.2 million. Only $1.8 million left. When you get hit by the final bus, the 45 percent estate tax robs $800,000 more… leaving your heirs that $1 million. Not a pretty tax picture.

Concept No. 2—The dollar amount you must invest in a life insurance product to leave $1 million to your kids/grandkids. Of course, your investment (the amount of your premiums) varies, depending on your age and health.

Suppose you and your spouse are both 60 yr. old, and you decide to buy a $1 million second-to-die policy to be fully paid in 15 years (called "15-yr.-pay" because premiums stop after 15 yr.)

My insurance guru—a genius at finding the lowest premiums with top-rated companies—quoted $18,149 per year, making the total premium $272,235 ($18,149 x 15).

Simply put, your $272,235 investment will get your heirs $1 million all tax-free from the insurance company.

NOTE: As long as you are insurable, no matter what your age, the numbers always work.

Concept No. 3—The tax benefits—yours for the taking—of life insurance. The cash surrender value (CSV) of your policy earns money, increasing your CSV. These earnings are tax-free. Your profit (the excess of your death benefit over your premiums cost) is income tax-free.

There are many ways to keep the death benefit of your policy free of the estate-tax monster. The most popular is an irrevocable life insurance trust (easy to do).

Let's summarize. Using the above example, your after-tax cost of $272,235 (investment in the form of premiums) does the work of earning $3 million (to leave $1 million to your heirs).

Most clients say, "Wow"and smile a lot.

Now, using the basic concepts above, let's take a look at three life-insurance strategies that very few professional advisors know about.

Strategy No. 1—"Health Guard." Combining long-term care and life insurance, here's a typical example: Mary is 65 and wants long-term care

(LTC) coverage. But she's healthy now and wonders how smart it is to pay premiums that would be a total waste if she never has a need for LTC.

Enter Health Guard. Mary pays a one-time premium of $100,000. Here's how the policy works:

a) She can get the $100,000 back at any time (prior to a claim).

b) If she never has an LTC claim, the policy is considered a life-insurance policy and will pay a death benefit of $166,406.

c) Whenever Mary has an LTC claim, it reduces the death benefit—dollar for dollar—by the amount of the claim. For example, if she has a claim of $16,406, the death benefit would be reduced to $150,000.

Health Guard is a smart idea for smart people who are considering LTC.

Strategy No. 2—The "Charity Loan Tax Magic" (CLTM). A front-page article in *The Chronicle of Philanthropy* titled "Sharing the Pain," bemoans the prediction that contributions for the nation's largest charities "will decline this year (2009) by a median of 9 percent." Ouch!

Here's a strategy—CLTM—that will help you and your favorite charity. The strategy works at any age, but let's use Joe (age 60) as an example.

Joe is earning 4 percent per year (subject to a 40 percent state and federal income-tax rate) on a $1 million investment. Joe would love to give part of that $1 million to his favorite charity (FC), but he doesn't want to give up any of that $40,000 of income, nor does he want to reduce the amount that will ultimately go to his kids.

Let's see how the CLTM strategy is a win-win for Joe (increases his annual income) and FC (gets a substantial gift immediately, with no cost to Joe). Sounds like tax magic. It is. Here's the simple two-step process.

Step No. 1—Joe creates a family limited partnership (FLIP) and loans it $1 million, payable at his death, with interest at 4 percent per year ($40,000).

Step No. 2—The FLIP purchases:

a) a $1 million policy on Joe's life (annual premium $19,160); and

b) a single premium immediate annuity on Joe (pays the FLIP an annuity every year—starting immediately and for as long as Joe lives—for $59,160).

Every year (until Joe dies) the annuity will come into the FLIP and go out as follows:

1) Interest to Joe	$40,000
2) Pay $1 million policy premium	19,160
Total	$59,160

Three cheers for charity:

Cheer No. 1—The way the numbers work out in Step No. 2 (after buying the policy and the annuity), the $1 million loan has exactly $114,972 left over, which is immediately donated to FC.

Cheer No. 2—Of course, Joe gets a $114,972 income tax charitable deduction in his 40 percent tax bracket. Joe saves $45,989 in income tax.

Cheer No. 3—Every year Joe saves (because of the annuity) income taxes and has more spendable income. Here's how:

	Before	After
Income to Jim		
From $1 million investment	$40,000	
From annuity		$40,000
Less — Tax		
40%	$16,000	
Note below*		$9,631
Spendable Income	$24,000	$30,369

*NOTE: A large portion of the annuity is tax-free, substantially lowering the income tax.

So Joe has $6,369 ($30,369 - $24,000) more every year to spend. And finally, someday Joe will go to heaven. No cheers, but more tax savings. When Joe dies the FLIP will collect the $1 million death benefit and pay off the $1 million loan in Step No. 1 above. The transaction will be structured to sidestep the estate tax on $1 million—estate tax savings is $450,000.

Strategy No. 3—Make all of your investment income—capital gains, interest and dividends—tax-free: Use private placement life insurance (PPLI).

Sounds almost too good to be true, doesn't it? Should the truth be known, PPLI is simply an investment portfolio in insurance clothing. Usually the investments are stocks and bonds, but can include derivatives, real estate investment trusts, timber and many others.

Stop for a minute and write down two numbers: how long do you think you will live and the dollar amount of your current investment portfolio.

Suppose you wrote down 21 years and $10 million. Can you guess how much your portfolio (say at a conservative compounded rate of 7 percent) will grow to in 21 years? If in a tax-free environment (like PPLI), the answer is $40 million. Simply, the growth of your tax-free cash surrender value of your PPLI.

If you need some of that CSV, just borrow it. Repayment can be deferred to the day you die.

Note: PPLI premiums start from a low of $1 million (for example, $250,000 per year paid over four years), to a more typical $5 to $10 million or more (paid in the early years) or a large ($5 million or more) paid as a single premium at inception. Yes, $50 to $100 million policies can be arranged.

Okay, you lucky readers with a large amount of investable assets, look into PPLI.

The above are just three of more than two dozen strategies that can help make you rich and, if you are affluent, significantly increase your net worth.

One warning: When working in the area of life insurance and annuities make sure you work with experienced and competent professionals. Always get a second opinion. Any questions, call Irv at 847/674-5295. **MF**