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More life insurance coverage can help protect your IRA

Buying more life insurance can be a good way to protect a large IRA.

By Elliot Raphaelson, Tribune Content Agency
The Savings Game

Thanks to the impressive gains in the stock market over the last 10 years, many IRAs and other retirement accounts have grown substantially in value. But the bull market won't last forever. What will happen if the market corrects or cools off?

Ed Slott, an expert on IRAs, has pointed out that life insurance is not only "the single biggest benefit in the tax code"; it is also "the most cost effective way to protect a large IRA." (Check out Slott's website, IRAHelp.com.)

Many people, once they reach 70 1/2, are forced to withdraw more money from their IRA than they wish to. These individuals should consider using the after-tax proceeds from the required minimum distributions (RMDs) to pay for life insurance premiums. After the death of the IRA owner, the life insurance proceeds can be used to pay any estate tax or other post-death expenses so the beneficiaries of the IRA will not have to.

The use of life insurance eliminates tax risk. The payment is guaranteed. For sophisticated investors who are nervous about the direction of the stock market, expanding their life insurance coverage will certainly provide some protection from investment risk.

Under current regulations, an individual can shelter \$11.2 million from estate and gift taxes; couples can shelter up to \$22.4 million.

Many individuals make the maximum contributions to their IRA plans, 401(k)s and other retirement plans. It makes sense to consider buying additional permanent life insurance to provide additional tax benefits when you have made the maximum contributions to these retirement accounts.

If you are in retirement and are required to make withdrawals from your assets to meet normal living expenses, using the cash value from your insurance policies is more cost-effective than withdrawing funds from taxable retirement funds. Withdrawals from cash value will have no impact on your tax bracket. It is possible that withdrawals from your taxable retirement accounts will push you into a higher tax bracket.

If you do not have sufficient long-term care coverage, consider using long-term care riders associated with some life insurance policies. Discuss this option with your life insurance agent. You can be sure that your beneficiaries would prefer that you use this option than depend on them to pay for nursing home costs or the costs of assisted living.

In previous columns, I have discussed the value of the "stretch option" for beneficiaries of IRA accounts. If these beneficiaries are also the beneficiaries of your life insurance policies, this will enable them to use these non-taxable proceeds and not have to withdraw amounts in excess of their required distributions on inherited IRAs. This will allow them to minimize taxes and adhere to the maximum stretch. Even if your beneficiaries inherit Roth IRAs, receiving insurance proceeds will allow them to maintain the Roth accounts longer and have the proceeds tax free.

Another advantage of buying more life insurance is that it can give some leeway to a surviving spouse to convert a regular IRA into a Roth IRA. The spouse can use life insurance to fund a trust. The use of an IRA would have required minimum distribution requirements and tax implications. From a planning perspective, life insurance proceeds are more flexible than other alternatives.

Buying life insurance has some disadvantages: There are no tax advantages for making the initial premium. Insurance policies are not flexible in early years. They are not liquid in the short term. Funds are tied up long term. Policy withdrawals

reduce the death benefit. Using cash value to pay premiums reduces the death benefit.

The bottom line is that life insurance can provide significant benefits, depending on your particular financial situation. Discuss the advantages and disadvantages with your attorney, financial planner and life-insurance agent.

(Elliot Raphaelson welcomes your questions and comments at raphelliot@gmail.com.)
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