Advantages and Disadvantages of Life Insurance

Life insurance offers several advantages not available from any other financial instrument; yet life insurance also carries some disadvantages.

Advantages of Life Insurance

- Life insurance provides an infusion of cash for dealing with the adverse financial consequences of the insured's death.
- Life insurance enjoys favorable tax treatment unlike any other financial instrument.
  - Death benefits are generally income-tax-free to the beneficiary.
  - Death benefits may be estate-tax free if the policy is owned properly.
  - Cash values grow tax deferred during the insured's lifetime.
  - Cash value withdrawals are treated on a first-in-first-out (FIFO) basis, therefore cash value withdrawals up to the total premiums paid are generally income-tax free.
  - Policy loans are income tax free.
  - A life insurance policy may be exchanged for another life insurance policy (or for an annuity) without incurring current taxation.

  Note: All of the above statements are generally true; however, the tax benefits of life insurance have certain limitations which under the wrong set of circumstances can cause the tax benefits mentioned to be lost. Please refer to the important disclosures on Page 2 and discuss your particular situation with your tax or legal advisor.
- Many life insurance policies are flexible in terms of adjusting to the policyholder's needs. Some policies allow the death benefit to be decreased at any time, and premiums to be reduced, skipped or increased.
- A cash value life insurance policy may be thought of as a tax-favored repository of easily accessible funds if the need arises; yet, the assets backing these funds are generally held in longer-term investments, thereby earning a higher return.

Disadvantages of Life Insurance

- Policyholders forego some current expenditure to pay policy premiums. Moreover, life insurance is typically purchased for the benefit of others and usually only indirectly for the insured person.
- Cash surrender values are usually less than the premiums paid in the first several policy years, and sometimes a policyowner may not recover the premiums paid if the policy is surrendered.
- The life insurance purchase decision and the positioning of the life insurance can be complex, especially if the insurance relates to estate planning, business arrangements, or complex family situations.
- The life insurance acquisition process can be annoying and perplexing (e.g., is the life insurance agent trustworthy? Is this the right product and carrier? How can medical underwriting be streamlined?)

Refer to the important disclosures on page 2 of 2.

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Important Disclosures

For federal income tax purposes, life insurance death benefits are generally paid income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e., the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

Distributions from life insurance policies prior to the death of the insured may be subject to income taxation depending on the type of distribution (i.e., withdrawal, surrender, loan or dividend), the life insurance policy duration at the time of distribution, and effective tax law at that time. These distributions may also reduce policy cash values and death benefits. Withdrawals and other distributions from non-Modified Endowment Contract (non-MEC) policies in the first 15 years may be taxable to the extent they occur in conjunction with (or during the two years immediately prior to) a reduction in benefits. After 15 years, withdrawals and other distributions up to the life insurance policy cost basis are not taxable. Life insurance policy loans are not taxable for a non-MEC policy provided that it remains in force until the death(s) of the insured(s). Withdrawals, policy loans and other distributions from a MEC policy are subject to other rules and are generally taxable as "income first." If prior to the death(s) of the insured(s) the policy (MEC or non-MEC) is surrendered or lapses with an outstanding policy loan balance, the policy owner will be subject to income taxes to the extent the cash surrender value plus the amount of the outstanding loans exceeds the policy cost basis. Withdrawals, policy loans, and other distributions will reduce policy values and may reduce death benefit.

Life insurance policies include certain non-guaranteed elements, including premiums, credited interest rates, values, charges, etc. Non-guaranteed elements are not guaranteed by definition. As such, life insurance carriers reserve the right to change or modify any non-guaranteed element. This right to change non-guaranteed elements is not limited to a specific time or reason. Life insurance products are issued by unaffiliated third-party insurance companies. Guarantees are based on the claims-paying ability of the issuing insurance company.

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