



A University of Hawai'i Cooperative Extension Service Project

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Course Objectives



- Increase your knowledge about financial planning
- Improve your ability to make informed decisions



Creative Uses of Life Insurance

Presenter



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Lesson Objectives



- Understand traditional uses of life insurance
- Learn new concepts and uses of life insurance that may enhance your financial plan

Creative Uses Of Life Insurance



LIFE  **INSURANCE**
AWARENESS MONTH
BROUGHT TO YOU BY LIFE HAPPENS®

Life Insurance Has Many Uses



- Traditional Uses
 - Pay off mortgage
 - Pay off debts
 - Provide for education for the children or grandchildren
 - Provides monthly income for survivors
- Used properly, it can have many additional uses

Supplemental Retirement



Make the Rest of Your Life
the Best of Your Life



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Supplemental Retirement



- Structuring a life insurance policy to allow for income tax free distributions in the future to “supplement other retirement income”

Supplemental Retirement – Key Design Features



1. Using after tax premiums
2. Policy should be designed as a non Modified Endowment Contract (MEC)
3. Minimize the death benefit based on premium available

Supplemental Retirement Options



| | Annual Limits on Contributions | Pre-Tax Contributions | Tax-Deferred Accumulation | Tax-Preferred Distribution | Income Tax Free Death Benefit |
|--------------------------------|--------------------------------|-----------------------|---------------------------|----------------------------|-------------------------------|
| Traditional IRA | YES | YES | YES | NO | NO |
| Roth IRA | YES | NO | YES | YES | YES |
| Qualified Plan 401(K) | YES | YES | YES | NO | NO |
| Mutual Funds | NO | NO | NO | NO | NO |
| Non-Qualified Deferred Annuity | NO | NO | YES | NO | NO |
| Life Insurance | NO | NO | YES | YES | YES |

Examples for
Male Age
45 Qualifying
as Preferred
Nonsmoker



- Premium of \$25,000/year for 20 years (\$500,000)
- Distributions payable from age 66 to age 80
- \$77,681 yearly using Indexed Universal Life
- \$63,135 yearly using Whole Life

People That Might Consider This Option



- Anyone that has maxed out all qualification plan contributions for the current year and the foreseeable future
- Higher earners

Annuity Maximization



Taxable vs. Tax Deferred



- Deferred annuities are an excellent way to save money for the future
- However if the purpose changed as the years passed and now you wish to leave the money to heirs, there are other options

Taxation of Annuity Proceeds At Death



- Non-spouse
- Nonqualified annuity
 - Full distribution is subject to Income in Respect of a Decedent (IRD)
 - Must distribute over 5 years

Taxation of Annuity Proceeds At Death



- Qualified plan annuity (fully taxable)
 - Entire distribution
 - Must distribute over 5 years
 - Stretch IRA over life of beneficiary where applicable
- While some annuities pay a “death benefit”, it is not usually treated income tax free like life insurance

Annuity Maximization Strategy



- Reposition annuity into an immediate annuity
- Or take annual distributions from the annuity
- Use the income to purchase a life insurance policy
- The income tax free death benefit will normally exceed the net amount payable from the annuity by a multiple depending on the ages

Example For Husband & Wife Age 70



- Annuity value is \$500,000 currently
- Cost basis of annuity is \$250,000
- Projected value in 20 years is \$903,056
- Taxable gain is \$653,056
- Ordinary income tax of \$195,916
- Net to family of \$707,140

Annuity Maximization Results For The Family



- Husband & wife do not need the income so they purchase a joint life and cash refund annuity paying \$2,615 (\$31,380 annualized)
- They use the income to purchase a second to die life insurance policy for \$1,118,620 which will go to the family income tax free

Annuity Maximization Advantage



- Annuity provides the family \$707,140 after a 30% IRD tax
- Life insurance provides the family \$1,118,620 tax free
- Advantage is \$411,480

Note: medical qualification, future tax rates, interest paid on annuity and cash flow from immediate annuity may cause different results

Taxation of Annuity Distributions During Life



Any non qualified deferred annuity funded after 1982 with new after tax money, distributions will be taxed as income as follows:

- Interest earned is taxed first
- Once all interest is distributed and taxed, then after tax principal is distributed

Summary



Life Insurance can be used:

- Own personal benefit
- Benefit for beneficiaries

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Credits



We would like to thank the following groups for their support:

- University of Hawai'i at Mānoa
 - College of Tropical Agriculture & Human Resources, Cooperative Extension Service, Department of Family & Consumer Sciences
 - Information Technology Services-Academic Technologies
- First Hawaiian Bank
 - Wealth Advisory Division