Life insurance:
Knowledge is power

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Most people know that life insurance pays benefits to those named as beneficiaries of the deceased's life insurance policy. But did you know that there are many other ways to use life insurance as part of your financial planning?

Financial strategies using life insurance as your bank

When using your credit card for purchasing things like car loans and other lines of credit—including student loans—the interest you end up paying for your credit can begin to add up. When you combine the interest you lose to your creditors with the interest you would have earned on the interest paid to them, the costs can cause significant loss to your wealth, both individually and as a family unit.

But what if you save aggressively, buying a certain type of life insurance policy? You could pay for all your credit purchases from your life insurance policy and then pay back what you have borrowed, plus interest. This way, rather than making banks richer, you make you and your heirs wealthier when your policy pays them off at your passing.

Moreover, you receive all the benefits of a complete life insurance package, which includes the following:

- A fixed and guaranteed death benefit that goes to your beneficiaries, tax-free
- Growing cash value at a guaranteed minimum rate with zero risk of market loss
- Growth, withdrawals and loans that are all tax-free

Additionally, if your policy is issued via a mutual insurance company, policyholders now own it, which means you are now granted annual dividend payments.

Sound too good to be true? It isn't! And it's perfectly legal!

Please note that that this plan of borrowing from yourself to then pay yourself back by using your life insurance is not for everyone. For the concept to work well, several factors have to be in place.

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Using life insurance to fund an irrevocable trust

One such factor is by making the beneficiary of your irrevocable trust the same as the beneficiary of your life insurance. This is helpful for lowering both income tax and estate taxes, while significantly growing the amount for your heirs. Here is how this works.

When the insured passes on, the life insurance pays out a death benefit—which is not taxable income—that is a certain multiple of premiums paid. So when an individual invests trust assets into a life insurance policy, a person can move significant assets to heirs without any income or estate tax liabilities. This has become such a common practice for funding trusts that it's garnered its own term, ILITs, or "Irrevocable Life Insurance Trusts." Another advantage of this method is that it provides liquidity for heirs who might otherwise be forced to sell the family business. But with the purchasing of life insurance through an ILIT, their heirs are given tax-free funds to counterbalance any estate tax that they may owe.

Using life insurance for getting a bank loan

Many lenders, including banks require borrowers—for business or personal loans—to buy term insurance that protects the bank in case the borrower dies before the loan is repaid. Doing this not only guarantees that the bank receives its money in the event that you unexpectedly die, it also relieves your heirs from feeling pressured o take funds from your trust or estate to repay the loan. This is a win for your estate, a win for the lender, and a win for your heirs.

When applied, life insurance is useful for far more than leaving cash behind for a loved one. Speak with your retirement planner to see what role life insurance may have in your estate planning.

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