NexGen INSURANCE STRATEGIES

Trading Taxes For Policy Charges

Variable Universal Life (VUL) Insurance vs. Buy Term and Invest the Difference

A VUL policy's combination of death benefit and cash value build-up potential can make it an efficient asset location in which to invest money to provide financial security for one's beneficiaries and accumulating wealth tax efficiently. Should the insured die prior to retirement, for example, the death benefit, which is generally received income tax free, can compensate beneficiaries for lost future retirement plan contributions by the insured, pay off debts such as a mortgage, fund education expenses for children, etc.[1] Upon (or even before) retirement, the policy owner can take tax-free distributions from the cash value as a source of supplemental income.[2]

The cash value can be invested in traditional investment options resembling mutual funds with similar risk and return characteristics, as made available by the insurance carrier.[3] The cash value grows tax deferred and can be accessed income tax free, but charges are deducted monthly to fund the death benefit element of the policy. Alternatively, if the VUL premium is used to buy term insurance and the difference is invested in a taxable portfolio of traditional investments, as many detractors often suggest, the investor would be subject to taxation on realized gains and earnings. Moreover, the investor could lose the death benefit protection after the term policy expires which can be challenging or cost prohibitive to reacquire if it is still needed, as it often can be.

Because the underlying investments can be comparable, a key tradeoff made when buying a VUL policy instead of buying term and investing the difference in a taxable portfolio is paying policy charges instead of taxes. Structured properly, the policy charges can be cheaper long term making VUL a cost-effective complement to a diversified, long-term investment strategy.

Hypothetical Example (Download Full Analysis)

	Variable Universal Life Insurance	Taxable Portfolio SPECIFIED Rate of Return	Taxable Portfolio MATCHING VALUES Rate of Return
Gross Rate of Return Assumption:			
a. Illustrated Annual Rate of Return	**7.00%** (Net of Management Fees)	**7.00%** (Net of Management Fees)	**8.06%** (Net of Management Fees)
Cost-Benefit Summary at Life Expectancy (Age 88):			
Total Net Outlay Over Years 1 to 10	**1,000,000**	**1,000,000**	**1,000,000**
b. Total Taxes	0	862,529	1,117,079
c. Total Policy Charges or Term Premiums	221,576	13,800	13,800
Total Internal Costs (b+c)	**221,576**	**876,329**	**1,130,879**
d. Total After-Tax Income Over Years 21 to 40	4,497,760	3,679,738	4,497,760
e. Net Account Value	98,642	98,642	98,642
f. Net Death Benefit	328,966	98,642	98,642
Total Benefits During Life (d+e)	**4,596,402**	**3,778,380**	**4,596,402**

	Variable Universal Life Insurance	Taxable Portfolio SPECIFIED Rate of Return	Taxable Portfolio MATCHING VALUES Rate of Return
Internal Rate of Return (IRR) Analysis at Life Expectancy (Age 88):			
g. IRR on Net Account Value	**6.45%** ← 89 bps of Locational Alpha	**5.56%**	**6.45%**
h. IRR at Death	**6.56%**	**5.56%**	**6.45%**
Annualized Cost Drag (a-g)	**0.55%**	**1.44%**	**1.61%**
Annualized Cost Ratio (1-((1+g)÷(1+a)))	**0.52%** ← 83 bps Less Cost Ratio	**1.34%**	**1.49%**

Assumptions Used in the Above Example

VUL and Term Policy Hypothetical Assumptions:

- Male, age 48, preferred non-tobacco risk class
- Variable Universal Life (IUL) policy from a highly-rated carrier
- $100,000 annual premium for 10 years
- Minimum non-MEC face amount and Death Benefit Option B switching to A
- Solving for annual income from year 21-40 to $1,000 of cash value at maturity based on a 7% net annual rate of return and non-guaranteed charges
- At an annual 0% gross return, maximum policy charges, and the illustrated annual income of $224,888 beginning in year 21, the policy would lapse in year 22
- Level term policy annual premium of $1,380 and face amount of $1,500,000 in the taxable portfolio

Taxable Portfolio Hypothetical Assumptions:	SPECIFIED Rate of Return	MATCHING VALUES Rate of Return
Equity Capital Gain Rate	5%	5.76%
Equity Dividend Rate	2%	2.30%
Total Rate of Return (Capital Gain + Dividend)	7%	8.06%
Annual Capital Gain Turnover Ratio	10%	10%
Capital Gain and Dividend Tax Rate	23.8%	23.8%

This Strategy may be suitable for the following:

- High-income earners (e.g. doctors, lawyers, professionals, business owners, executives, athletes, entertainers);
- who have a need for life insurance death benefit protection;
- are maximizing contributions to available traditional tax-deferred retirement plans;
- have at least $20,000 of disposable income per year to invest; and
- would like to invest the money in a tax-efficient asset location to provide financial security for their beneficiaries and attractive wealth accumulation potential for themselves.

Variable life insurance is sold by prospectus. Please consider the investment objectives, risks, charges, expenses, and your need for death-benefit coverage carefully before investing. The prospectus, which contains this and other information about the variable life policy and the underlying investment options, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

The investment return and principal value of the variable life policy are not guaranteed. Variable life sub-accounts fluctuate with changes in market conditions. The principal may be worth more or less than the original amount invested when the policy is surrendered.

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1 The ability to acquire a VUL policy is dependent on meeting the insurance carrier's financial and medical underwriting requirements. If an interest in the policy is transferred for valuable consideration in a transaction that does not qualify for an exception ("certain person" or "carryover basis" exceptions) or that is a reportable policy sale, the death benefit in excess of cost basis may lose its tax-exempt status and be included in gross income of the beneficiary. See IRC § 101(a) and regulation § 1.101-1. Similar gross income inclusion may apply where an employer is the owner and beneficiary of a policy acquired on an employee and it failed to satisfy the Notice and Consent requirements prior to issue or an employer receives accelerated death benefit amounts under a policy insuring an employee due to chronic or terminal illness. See IRC §§ 101(j), (g).

2 Income tax-free access to cash value assumes that the policy never becomes a Modified Endowment Contract (MEC), withdrawals are limited to cost basis, policy loans are taken to access gain and the policy does not lapse during life with outstanding policy indebtedness. See IRC §§ 7702A and 72(e). Withdrawals and policy loans reduce the death benefit payable to beneficiaries. If a policy lapses or is surrendered during life, any gain realized (cash surrender value plus outstanding indebtedness minus cost basis) is included in gross income of the policy owner. See IRC § 72(e).

3 Performance is based on non-guaranteed charges and credited interest rates that will fluctuate and be better or worse than illustrated.

Hypothetical and for illustrative purposes only. Actual results will vary.