Life insurance adds diversity and underappreciated benefits to retirement planning

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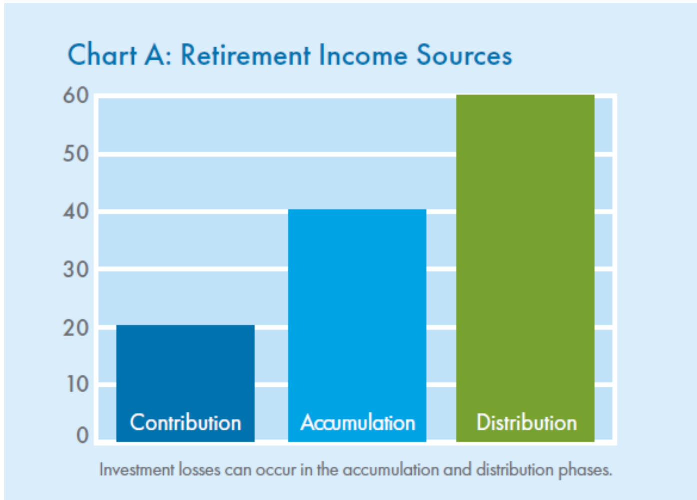
Planning for retirement can be a struggle at any income level. For many, the challenge is simply to ensure that the money won't run out, so that they can enjoy their "golden years" without worrying constantly whether they have enough funds to cover expected living and medical expenses, and still be able to leave something for their loved ones. For others, who have been more fortunate financially, the challenge may be different, but it often requires just as much, if not more, planning if they want to maximize both the enjoyment of their own retirement and the legacies they leave behind for their families.

Ideally, when building a retirement nest egg, you should think of each dollar that you put toward retirement as going through three phases: contribution, accumulation and distribution. To maximize the odds of securing a financially solid base for your retirement, your retirement fund should grow in each phase.

The difficulty is that as maximum marginal tax rates rise (as they recently have) traditional vehicles for accumulating wealth for retirement, such as the 401(k) and the individual retirement account (IRA), become less effective at preserving wealth. The benefits of making deductible contributions and enjoying tax-deferred growth can easily be outweighed down the road by high marginal tax rates when the need to begin making taxable, mandatory withdrawals (required minimum distributions, or RMDs) kicks in, currently at age 70 ½.



In addition, upon the owner's death, when the assets of an IRA or 401(k) pass through inheritance to the plan's (non-spouse) beneficiaries, they do so as regular income and hence are often taxed at a high rate, since beneficiaries are often in their 50s or 60s, statistically the years of many individuals' highest earnings and correspondingly peak tax rates.

Some retirement plans enable you to avoid these problems by giving you the ability to accumulate and distribute assets without paying taxes, though with the (significant) drawback that the initial contributions are nondeductible. The Roth IRA is a very popular example of this kind of plan. In addition to providing a vehicle for tax-deferred growth and zero taxes on qualified distributions, the Roth IRA has the benefit of requiring no mandatory withdrawals for Roth IRA owners, and of passing income-tax free to the plan's beneficiaries upon the owner's death.

Unfortunately, the Roth IRA also has several drawbacks, which, for some, particularly high earners, are significant. For example, single taxpayers with modified adjusted gross annual incomes above $127,000 (or above $188,000 for married couples filing jointly) are ineligible to contribute to Roth IRAs. And even for those under these amounts, the Roth IRA, like its traditional IRA cousin, limits the maximum amount of annual contributions to $5,500 (or $6,500 for those ages 50 or over). Also, if you skip one or more years in contributing to a Roth IRA, you are not allowed to "make it up" in later years; those potential contributions and the benefits that would have accrued to them are simply lost.

A Way Out - There is little doubt that, despite their drawbacks, the 401(k), IRA, Roth IRA and other similar retirement plans can be tremendously useful in planning for retirement. But it is also important to realize that their utility can be greatly enhanced by the use of other investments to help offset some of these limitations and add diversity to your overall retirement portfolio.

Life insurance is a prominent example. Unlike the case of contributions in all of the plans discussed above, there are no IRS-imposed annual limits on premium amounts for life insurance, and there are also no income limits on who is allowed to purchase it, as there are with Roth IRAs. In addition, many life insurance policies will allow you to skip or reduce premium payments at any time, and then make these up at a later date.

In addition, unlike 401(k)s and traditional IRAs, life insurance benefits generally flow to your beneficiaries, tax free upon your death. Moreover, unlike any of the retirement plans discussed above, life insurance is a "self-completing" asset, meaning that the full benefit of your policy will be paid to your beneficiaries even if your death occurs before funding is completed.

Being smart about retirement planning will always require considering multiple investment options to help you reach your goals. Because of the many balancing benefits that it brings to the table vis-à-vis traditional retirement plans, life insurance is an important element to consider adding to the mix to help ensure your own peace of mind about the future retirement and legacy you have worked so hard to build.