Indexed Universal Life Insurance Tax Advantages

Under the current Internal Revenue Code, Indexed Universal Life insurance has a "unique combination of tax advantages" that are not available with any other financial, investment, or cash accumulation product [1].

These advantages include:

1. ***Tax deferred*** *accumulation of cash values*
2. ***Tax free income*** *via withdrawals and policy loans*
3. ***Income tax free proceeds*** *to policy beneficiaries at death*

Tax-deferred accumulation of cash values

The basic reason to own indexed life insurance is to provide for your family's financial security in the event of a premature death. However, **a secondary motive** for buying indexed universal life insurance is **the advantage of tax deferred cash value growth**. With indexed universal life insurance, for example, cash values will accumulate over time if actual premium payments exceed the policy's expenses and insurance costs. Each year, interest is credited to the policy's cash value based on the performance of a stock index (i.e., S&P 500, Dow Jones, or NASDAQ). Cash values will continue to grow tax deferred, as long as mortality costs and fees are covered, until they are withdrawn, borrowed or the insured dies. The advantages of tax deferred growth can also be found in other financial and investment products. Annuities and qualified retirement accounts are just two examples of products that also offer tax deferred growth of accumulated values. However**, life insurance is the only cash accumulation product available** that offers the combination of tax deferred growth of cash values **with the ability to structure cash distributions that may be received tax-free**.

Tax-Free-Income via withdrawals and policy loans

The second tax advantage found in an equity-indexed life contract is that **cash value distributions may be accessed from the policy tax-free**. If structured properly, policy withdrawals and loans can be used to essentially eliminate income taxes on cash received from the life insurance policy.

Withdrawal of cash value from a life insurance policy is generally not taxable as long as the amount withdrawn does not exceed the policy premiums that have been paid to date, also known as the policy's "basis". The **Internal Revenue Code Section 7702A** provides the definition of life insurance for tax purposes. For specific details on IRC 7702A see, "The IRC and Life Insurance Tax Strategies." As long as the life policy qualifies under IRC 7702A, and is not classified as a modified endowment contract (MEC), withdrawals are not subject to tax until cash value's withdrawn exceed the policy's premium basis. Once the policy's basis has been withdrawn, future withdrawals may be subject to income taxation.

To avoid taxation on policy distributions above the policy's basis, policy loans can be used to access additional cash values **tax-free**. As long as the insurance policy is not considered a MEC (Modified Endowment Contract), policy loans are not taxable. If cash values are received via policy loans, there is no income tax on the amount borrowed, but loan interest will be charged by the insurance company on any outstanding loan balance. Policy loans do not have to be repaid. However, if an outstanding loan is not repaid before the insured's death, the policy loan balance including any unpaid interest will be deducted from the policy's death benefit.

Even though policy loans are not taxed, there are certain conditions when taxes on loans may apply. For example, if a policy is *surrendered* or *lapses*, income taxes will apply. If a policy is *surrendered (cashed in/totally liquidated)*, any amount of cash values actually received in excess of the policy's basis will be subject to income taxation. Existing policy loans are then considered cash distributions and included in the calculation of the policy basis. If a policy *lapses*, any outstanding loans are treated as cash value distributions and subject to taxation on any amount in excess of the policy basis. Policy lapses may have a devastating effect on existing policy loans as there will be no cash available from the policy to potential taxes. For this reason, many companies offer lapse protection riders that are available on policies where cash accumulation is a primary objective.

Conclusion

Income tax free proceeds to policy beneficiaries at death

Under the current IRC, life insurance death benefits are payable to a named beneficiary are received income tax free. When an insured dies, life insurance policy proceeds less any policy loans and accrued interest are customarily paid to the policy's beneficiary(s) in one lump-sum. This lump-sum is free from any income tax.

Tax advantages make indexed universal life insurance a great supplemental option

Indexed Universal Life insurance has a unique combination of tax advantages, including tax-deferred growth of cash values, tax-free income via withdrawals and policy loans, and tax-free death benefits. **This combination of attributes is not found in any other cash accumulation product. These special tax features make indexed universal life a supreme solution for cash growth, tax-free supplement retirement income and family security.**