

## The Single Premium Life Solution

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For example, what about the grandparent-retiree who is in solid shape financially and has a \$50,000 or \$100,000 CD or bond coming due, and does not need that money for current living expenses? Amounts like these are probably not large enough to efficiently utilize complex planning strategies, but they are large enough to provide a generous gift for future generations.

A single premium life insurance policy can be the right fit for this situation; as long as the money is not needed elsewhere during the customer's lifetime and the client fully understands the taxation issues with respect to such a policy. Let's review single premium life policies and how they differ from traditional universal life insurance.

### **An MEC discussion**

A single premium life insurance policy is typically one form of a modified endowment contract (MEC). The laws and regulations surrounding MECs were created to discourage the use of insurance as a short-term, tax-deferred investment vehicle. This was accomplished by changing the taxation of distributions from an MEC during the insured's lifetime, but keeping intact the same taxation of the MEC upon death of the insured and including it in the definition of insurance under Section 7702. A life insurance policy is classified as an MEC when the policy is funded more rapidly than a paid-up policy based on seven statutorily defined level annual premiums.

Lifetime distributions from an MEC are taxed as ordinary income until they exceed the total gain in the policy, which is the opposite treatment from non-MEC insurance contracts. Furthermore, lifetime distributions from an MEC can also be subject to an additional 10% excise tax if the distribution is taken when the policy owner is less than 59½ years old.

If a single premium policy is usually an MEC, which sounds bad at first blush, why are we talking about it?

Single premium policies can use some of the differences in taxation from a non-MEC policy to provide great advantages in certain situations. Utilizing these advantages can help you build trust with your prospects and establish you as an innovative problem solver. Let's look at an example:

Let's assume we have a widow who has \$40,000 about to mature in a CD at her local bank. She is 65 years old and realizes that her careful planning over the years has given her a stable income throughout her retirement years, and will enable her to make a gift to her two grandchildren.

What would a deferred annuity provide as a gift in this situation? Assuming the deferred annuity produces a net return of 6 percent annually, and if the grandmother were to pass away five years after purchasing the annuity, the value would be \$53,530. The grandchildren, as beneficiaries, would certainly have access to the funds, but the \$13,530 in gains would be fully taxable as ordinary income to the kids, and annuities do not receive a step up in basis upon the death of the owner, unlike other assets.

A single premium life insurance policy could provide an attractive alternative in this situation, particularly if the grandmother does not need access to the funds for current living expenses.

In our example, the grandmother could apply for a life insurance policy with a single premium payment of \$40,000, and receive the maximum guaranteed face value, which we will estimate at \$80,000. If she dies after one year, the grandchildren, as the beneficiaries, will receive that \$80,000 income tax free, and if she dies after five years the grandchildren will get at least the \$80,000 or slightly more, depending upon tax-deferred growth within the policy.

An annuity would be hard pressed to outperform the guaranteed death benefit available with a single premium life policy — particularly since the annuity will produce an income taxable event.

While a deferred annuity can provide tax-deferred growth on the entire principal, it may ultimately provide fewer dollars and a higher tax burden to the beneficiaries upon the owner's death. The bottom line is that a single premium life insurance policy can be a good way to maximize the legacy to be passed on to heirs.