

Advanced Planning: Life Insurance Tax Planning

[Music begins]

Presenter: I have a question for you. Can you name the eight most common tax planning opportunities you find with permanent cash value life insurance? I bet you can't. But that's okay because I'm going to cover them right now in this podcast. So, let's go.

The eight most powerful tax planning opportunities of permanent life insurance.

You know, when you think about cash value life insurance, there are so many tax planning opportunities. I think the best way to organize it is to break it down between living benefits and the death benefit. So, let's start with living benefits first and without question, the nontaxable cash value accumulation or so-called buildup within a permanent life insurance policy is a great tax planning tax deferral strategy. Many people take advantage of that. It's really one of the reasons why permanent life insurance makes sense for tax planning. Along the same lines, policy loans, when you borrow against a life insurance policy, assuming it's not a modified endowment contract policy loans are also nontaxable. So, we want to make sure to keep the policy in force; make sure it doesn't lapse. Those policy loans are a great way to access cash value without current taxation.

How about distributions or withdrawals? So now we're talking about non-loans, just a straight distribution from a policy. Assuming the policy is not considered a modified endowment contract, distributions of cash value up to cost basis are also received income tax free. Cost basis is generally going to be the amount of premiums the client has paid in overtime. If you're not sure, contact AuguStar and we can let you know what their cost basis is.

How about modified endowment contracts? Are there any advantages there on the buildup side? Absolutely. The tax code also provides for deferral of cash value buildup within a MEC. So, even if it's a modified endowment contract, that policy still enjoys nontaxable inside buildup within a MEC.

Accelerated payments of death benefits. So, at AuguStar, we have an amazing, accelerated benefit rider. We also have a terminal illness rider. Those riders are received income tax-free under code section 101G. So, the Internal Revenue Code is friendly to lifetime payments of death benefits. So accelerated payments of death benefits.

So now let's turn our attention to the death benefit side of the ledger. And without question, the income tax-free nature of a death benefit is one of the bedrocks of tax planning when it comes to life insurance. You know, generally speaking, payment of that death benefit, receipt for the death benefit by the beneficiary is income tax free.

Now, of course, there are exceptions. Sometimes in a business setting, taxes can be triggered. Or if you get into a so-called three-party Goodman tax trap, you know, taxation can occur. But generally speaking, the death benefit is received income tax free. And along those same lines, even if the policy is considered a modified endowment contract, the same rule applies.

So generally speaking, the death benefit is received income tax free. And then finally, with proper planning, we can avoid transfer taxes with that death benefit. So, things like gift taxes, estate taxes, generation skipping, transfer taxes, all of those can be avoided with proper planning. For example, the client can use maybe an irrevocable life insurance trust or have a third party own the policy or a spousal lifetime access trust. There are a variety of planning methods out there that we can structure in order to avoid those transfer taxes.

So, there you have it. The eight most common tax planning advantages of permanent life insurance. The nontaxable inside buildup of cash value, nontaxable distributions of cash value to basis, nontaxable policy loans, modified endowment contract inside buildup deferral, income tax free accelerated payment of death benefit, the income tax-free death benefit, income tax-free death benefit of MECs, and finally avoidance of transfer taxes with proper planning. It's an amazing number of tax planning advantages. And if you need help keeping up with all this, we've got your back because we have a handy one-page summary that you can access. The form is called Life Insurance Tax Planning. And the form number is 10224. Or if you'd like us to send a copy, reach out to either the sales support desk or the advanced planning department and we would love to get a copy of this in your hands so you can better help your clients. Go get them.

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If tax-free loans are taken and the policy lapses, a taxable event may occur. Withdrawals (partial surrenders) and loans from life insurance policies classified as modified endowment contracts may be subject to tax at the time the withdrawal or loan is taken and, if taken prior to age 59½, an additional 10% federal tax may apply. Withdrawals and loans reduce the death benefit and cash surrender value.

Products issued by AuguStar Life insurance company member of Constellation Insurance Inc. family of companies. Product, product features and rider availability vary by state. Guarantees are based on the claims paying ability of the issuer. Issuer not licensed to do business in New York.

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