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Your Money: Bad Advice Debunked

There's a myth about term life insurance that you need to know about

By Christopher R. Jarvis, MBA & Charles P. KinCannon, JD, LLM

Since October, we've been discussing the burden that comes with physicians' above-average financial status. As we've pointed out, most personal financial advice offered in mass media is directed at, well, the masses. Because this advice is tailored to the "average" person, and because you're anything but, you need advice that makes sense for you.

Physician families have substantially higher tax burdens and greater liability risk than the average American family. In this, the fourth and final installment of our series, we'll examine the risk associated with taking a piece of advice that is widely accepted yet inappropriate for high-net-worth individuals. (Did you miss the first three articles, "Half Price: Long-Term-Care Insurance," "Retirement Planning for the Above-Average," and "You're Not an 'Average American'"? Read them at www.PhysiciansPractice.com.)

Risk: Wasting money on taxes and term insurance premiums. Many financial advisers suggest buying term insurance, instead of permanent, and investing the difference in premiums in mutual funds and the like. This is excellent advice for the average American family, earning $42,000 per year, paying 12 percent in federal income taxes, and bearing no liability or estate-tax risk whatsoever. Such a family pays very little tax on investment income. Possibly, its tax on investment gains ranges from 10 percent to 15 percent. The average family does not worry about having their assets taken from them through a lawsuit. Further, such families purchase insurance solely for temporary income protection against the premature death of the breadwinner. The average family also has no interest in long-term liquidity for estate-planning purposes because it will never have an estate large enough to be subject to any estate tax. Does this sound like you? We didn't think so.

Suggestion: Buy cash-value life insurance as a supplemental investment tool that will offer permanent life insurance protection as well. You may be skeptical, but we're confident that our analysis here is correct. To spare you the pain of a long mathematical proof, look at the following simplified breakdown:

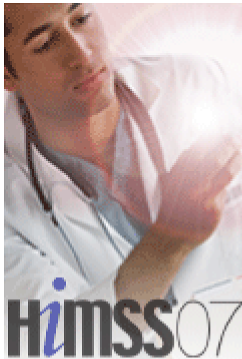
1. Mutual funds growing at 8 percent (taxable) are worth 5 percent to 6 percent (after taxes) to high-income taxpayers like you and 7 percent or more to average Americans.

2. Investment gains within cash-value life insurance policies are not taxed.

3. For relatively young and healthy insureds, the annualized cost of all internal expenses is 1 percent to 2 percent.

4. For families in high marginal tax brackets, the cost of an insurance policy is less than the cost of taxes on the same investment gains within mutual funds.

Without even factoring in the cost of the term insurance (which would reduce the



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total amount in the mutual fund portfolio), the cash-value insurance investment outperforms buying term insurance and investing the difference. Yet another benefit is that life insurance is protected from creditors — even from bankruptcy creditors, in many states. This is a benefit that may interest a physician family but be seen as worthless to average American families.

Consider a 50-year-old healthy male who wants to invest $25,000 per year for 15 years before retirement and then withdraw funds from age 61 to 90. Assume this individual's tax rate on investments is 31 percent. Assume the pretax return of both investments is 8 percent per year. Under that scenario:

- The individual who invests in mutual funds withdraws $37,000 per year after taxes (without purchasing any term life insurance).
- The individual who invests in cash-value life insurance withdraws $42,500 per year (paying no taxes on policy withdrawals and loans) and has $1 million worth of life insurance protection.

In this situation, it is pretty hard to see how buying term and investing the difference in taxable investments makes more sense than investing in tax-efficient life insurance for the highly compensated physician who is in a high tax bracket.

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