SOCIAL SECURITY LEVERAGING WITH LIFE INSURANCE

Upscale clients who are thinking of retirement may not need their Social Security retirement income to cover their fixed costs of living. They may have other sources of income such as rents, defined benefit pensions, K-1 “pass-through” income from ownership of S Corps or LLCs, required minimum distributions from IRAs, and other investment portfolio income.

Whether they retire at the full Social Security retirement age of 67 or wait for a maximum benefit at age 70 to take advantage of a payout that may be over 25% higher than age 67, these clients will have to decide where to place their after-tax Social Security benefits.

Your clients can simply place their unneeded after-tax Social Security into low yielding money market accounts, bank CDs, bond mutual funds, or U.S. government securities. And the low yields on these fixed assets are taxable as well.

Or they can allocate their after-tax Social Security benefits into an annual premium for a guaranteed no-lapse Universal Life (UL) or Survivorship Universal Life (SUL) policy where the death benefit for their heirs is income tax free. And the Internal Rate of Return (IRR) at life expectancy is substantially greater than current fixed financial asset yields.

Identify Current and Future Expenses

In the planning process, your clients should identify the amount of Social Security income that is NOT needed for their current and future retirement expenses. Inflation and potential long term care needs should be factored into the equation. Then your clients must decide where to place the after-tax funds NOT needed for fixed expenses. Shall it be a low yielding fixed financial asset or shall it be for an annual life insurance premium?

Depending on total income from all sources, Social Security benefits may be partly taxable. If 50% of Social Security benefits plus adjusted gross income exceeds certain unindexed thresholds, then up to 85% of these Social Security benefits are taxable as ordinary income.

Your clients can potentially increase the net inheritance to their heirs by purchasing the life insurance policy. The policy may be owned by the insured personally. Or the policy could be owned by an Irrevocable Life Insurance Trust (ILIT) if federal estate taxes and/or state estate taxes are a concern.

Let’s take a look at a simple example to illustrate the difference between placing the applicable after-tax benefits in a low yielding and taxable fixed financial asset versus the leveraged income tax free death benefit of a Survivorship UL policy (SUL).

Facts of Case and Comparison of Alternative Fixed Financial Asset to Life Insurance

Assume Mr. And Mrs. Johnson are both 67 years old and have decided to start taking their Social Security benefits. They have significant income from their rental real estate properties, a defined benefit pension from Mr. Johnson's prior working life, along with large IRA accounts and non-qualified investment portfolios. They expect to receive a combined Social Security benefit of about $60,000. When this benefit is added to their other income, this will mean that 85% of their Social Security benefits will be taxable income. They have a joint life expectancy of 24 years (age 91/91). Their assumed marginal income tax bracket is 35%. In other words, they get to keep 65% after-tax.

Calculation of After-Tax Social Security (SS) Benefits to be Re-Allocated

- $60,000 SS benefit x 85% = $51,000 of taxable income and $9,000 tax free income
- $51,000 x 65% = $33,150 after-tax PLUS $9,000 tax free = $42,150 total after-tax
- Assume a rounded off after-tax amount of $40,000 will be placed into either a low yield fixed financial asset with an after-tax yield of 3% (4.5% pre-tax) or as an annual premium into a guaranteed no-lapse SUL policy with preferred underwriting.

	Fixed Asset Fund	**Life Insurance Plan**
After-Tax Social Security Benefit	$40,000	$40,000
Cumulative Outlay Over 24 Years	$960,000	$960,000
Net to Heirs in Year 24 (age 91/91)	$1,418,000	$2,800,000
Potential Gain with Life Insurance	….......	+$1,382,000

As you can see from the simple comparison above, the life insurance death benefit of $2,800,000 provides a great IRR at joint life expectancy year 24 (7.80% IRR). This is a tax-free benefit which, in a 35% tax bracket, translates to a pre-tax equivalent IRR of 11.98%. If the clients live to age 95, the non-guaranteed fixed asset fund would only grow to $1,863,000. Even at age 100, the non-guaranteed fixed asset fund is only $2,378,000.

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