



## Wealth Planning Report

# Three Questions to Answer Before You Purchase Life Insurance

Life insurance can be an extremely important, even essential, part of your financial planning. Its most attractive aspect for most individuals and families is the policy death benefit—the guaranteed money that the insurance company pays out in the event of the insured’s demise.

But navigating the life insurance landscape can be tricky—and people often make costly mistakes. Three of the biggest we see regularly:

- Buying too much—or too little—insurance due to a lack of understanding of their true financial needs
- Misunderstanding the purpose of life insurance and the right reasons for having it
- Paying for life insurance using a less-than-ideal method or executing that payment method poorly

In order to make smart life insurance decisions, there are three questions you need to ask yourself and answer.

### Question #1: Why might I need life insurance?

Life insurance can be a very versatile tool, capable of replenishing an estate to cover various taxes as well as providing a wealth hedge replacing human capital.

That said, you may not *need* life insurance at all. Ultimately, there is only one reason to purchase life insurance: You lack the liquid financial resources needed to fill a significant wealth gap if you were to die.

That gap might involve:

- **Family.** Consider the people you love, such as your spouse or children. You want to ensure they would have a solid financial base (however you define it) if you were to die. Very often the best answer is using life insurance to create an instant estate for them.
- **Financial obligations.** Life insurance proceeds can be used to pay income and estate taxes, enabling children or other loved ones to preserve wealth that would otherwise would be lost to the government.

Likewise, entrepreneurs regularly use life insurance to fund buy-sell agreements with business partners. This helps mutually ensure their families will be properly taken care of. There are also circumstances in which you might owe a person or an institution and use life insurance as a form of collateral.

- **Charitable impact.** Many people want to support worthwhile charitable causes so they can have an impact—or at least make a difference. Life insurance can be used to complete their commitments to the philanthropic organizations they care deeply about.

**Important:** Be very clear about why you want life insurance. Carefully and critically think through the outcomes you are trying to achieve and the role life insurance might be able to play before you buy.

## HOW MUCH & HOW TO PAY

### Question #2: How much life insurance do I need?

Let’s say you determine that life insurance is something you need. It’s then time to turn to the matter of amount.

The answer to this question is based on your answer to the first question. When you know the purpose of having a death benefit for an unexpected event, it is possible to calculate just how much life insurance you need to get.

**Examples:** Say you are looking to create a larger estate to ensure your family would be financially secure if you died too soon. A lot of factors can be considered to come up with an appropriate death benefit. How sophisticated and involved you get depends on you (and an advisor you may enlist to help). For example, you might create cash flow projections to determine how much money your family would need to pay for specific projected expenses (education, health care, etc.). By including conservative investment returns into the calculations, you can arrive at the size of the death benefit your family would require to fund critical financial income needs and goals.

Or say you have a business you plan to pass on to your daughter. Although your son has different talents and interests, you still want to leave him an inheritance—and you want things to be “fair” to both. Life insurance can be used to equalize their inheritances without harming the business. Based on the financial value of the business you may leave to your daughter, you can determine how much life insurance you will need in order to leave your son a comparable amount of assets.

The upshot: Ascertaining how much insurance you require is fairly straightforward—but only once you are perfectly clear about why you need life insurance. Therefore, you should buy the amount of life insurance that matches your needs—and no more or less.

### Question #3: How should I pay for my life insurance?

Once you know how much insurance you need, you can consider various ways to pay the premiums. Basically, there are four approaches to paying premiums:

- **Pay the premiums out of pocket.** The least complicated and most direct way to pay premiums is to write checks for premiums as notices arrive.
- **Have a third party pay the premiums.** If you are an entrepreneur, your company might be the

appropriate entity to pay the premiums. Similarly, grandparents can pay the premiums for their grandchildren. (Note: There are rules that need to be followed to enable third parties to pay life insurance premiums without adverse consequences.)

- **Borrow the money to pay premiums.** This approach is known as premium financing. There are a number of different ways to use loans to pay premiums, but expertise in this area is often a necessity to structure loans successfully.
- **Leverage your retirement plan to pay premiums.** Some business owners may be able to use funds in a qualified retirement plan to buy life insurance. A special benefit is that pretax dollars are used to pay premiums. However, the IRS will consider the pure cost of life insurance protection provided under the plan to be an economic benefit treated as taxable income to the client.

Which way works best depends on a wide variety of factors. But the first step is to understand that you do have multiple options—don’t let anyone tell you there is only one method. And if you need guidance to make an informed decision contact an experienced wealth management CFP® professional.

\* Disclosure: A tax professional should be consulted on this matter.

This report is an executive summary of our e-book.  
For a complete complimentary report, call or email.



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Paul founded Professional Financial Strategies, Inc. in 1993 as one of the first independent financial and wealth planning advisory firms for affluent and aspiring families. Paul and his firm act as a personal chief financial officer for clients, bringing together a distinctive wealth management process and a network of experts that help families make smart decisions about money for investing wealth, mitigating excessive taxes, protecting assets from unjust loss, and making a real impact in passing a secure legacy to people they love and causes they care about that make a difference.

Paul earned pioneering designations as a Certified Financial Planner (CFP®), and ChFC® (Chartered Financial Consultant). A graduate with distinction from the University of Rochester, Paul earned an MBA in Finance from the Simon Business School. His professional education includes MFP (Master of Science in Financial Planning) and MSFS (Master of Science in Financial Services). Finally, *Who’s Who* presented Paul with the Albert Nelson Marquis Lifetime Achievement Award.

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