

The Insurance Counselor
Term or Whole Life?
Whole Life--Myths Dispelled
Part 2 of a 3 Part Series
By Chad D. Lueken, FICF



“And you will know the truth, and the truth will set you free.” John 8:32

Over the years we’ve heard all kinds of bogus claims about whole life insurance. It’s high time someone started telling the truth about it. Allow me. Following are the three most common myths I’ve encountered and the truth about each of them:

Myth #1. *The insurance company keeps the cash value when the insured dies.* This is technically not true. The cash value is actually a necessary part of the death benefit. Insurers know with measurable certainty that most whole life policies will pay out in a death benefit (unlike most term policies). Therefore, they must include cash values in their calculations. As the cash value increases, the net amount at risk for the insurance company goes down. It’s precisely because of this growth that the permanent death benefit is so affordable. Were it not for the cash value, few people could afford permanent protection.

What’s more, dividends from “participating” policies can purchase Paid-Up Additions (PUAs) which increases the death benefit, often for more than the face amount plus cash value. If you own a policy like this, the argument is pointless.

Myth #2. *Dividends from life insurance are taxable.* Structured correctly, dividends in W/L policies are not taxable because they are considered first a return of premium. Most W/L clients choose to put their dividends to work purchasing PUAs. So long as dividends remain inside the policy in this way, there’s no taxable event. Distributions from cash values are only taxable when the amount received exceeds the amount paid in premium (also known as the basis.) *Policy loans* against the cash value, however, are generally not taxable even if the amount borrowed exceeds the policy owner’s basis.

My explanation is for educational purposes only. For tax advice you should consult with a competent tax professional.

Myth #3. *Whole life insurance is more expensive than term.* If a person only needs coverage for a year or two then of course she would buy term insurance. Term is always less expensive upon purchase, but for the long term, a participating W/L policy could be much more cost effective. It really is the difference between renting and buying. For example, I recently compared one insurance company’s illustrations for both term and whole life policies. The face amounts and issue ages were the same. Here’s what I found:

The term policy had no cash value at the end of the 20 year term period, and no insurance coverage. It did have a renewability provision which allowed continued coverage for ten more years at an increased premium nearly seven times the original.

The W/L premium was initially about six times more than the term premium. But after 20 years, there would have been nearly 60% more in cash surrender value, including dividends, than his basis (dividends are not guaranteed). Keeping the policy another 10 years, under the same assumptions, the surrender value would be more than double what was paid in premium! The premium never changes but the death benefit continues to increase so long as dividends are buying PUAs. Some clients even find benefit in paying premiums with dividends instead of with cash out of pocket, though most professionals--including me--generally advise against it.

There is a fourth myth. You’ve heard it before. The saying goes “I can do better by buying term insurance and investing the difference elsewhere.” Next week I’ll share secrets wealthy people have learned about permanent insurance and why most of them own it. If you can do better than them, give me a call!

Call the Insurance Counselor toll free at 1-866-311-KOFC (5632) or email at chad.lueken@kofc.org
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