Common Objections to Life Insurance in a Qualified Plan

Common Objections

1. **Life insurance is a bad investment.**
   Life insurance is not an investment. Life insurance is first and foremost protection. In a qualified plan, it protects future retirement needs and assets against the risk of premature death. It provides liquidity, in a substantial amount, on a tax-favored basis, at just the time when it is needed the most.*

2. **It makes no sense to put a tax shelter in a tax shelter.**
   Life insurance in and of itself provides some attractive tax advantages, one of which is tax-deferred cash build-up. However, if you purchase life insurance outside of a qualified plan you will be paying the premiums with after-tax dollars. So, in this regard, it can be viewed as an incomplete tax shelter. If you can fully fund your retirement plan and also pay for all the life insurance you need with after-tax dollars, then funding a qualified plan with life insurance may not be right for you. Not everyone can do this, however, most people run out of cash before they run out of need. In that case, paying premiums with pretax dollars can help secure protection that might otherwise be unaffordable.

3. **Life insurance in a qualified plan is too complicated to administer.**

4. **I’ll just buy term insurance on the outside. It’s cheaper.**

5. **Life insurance will reduce the value of my plan at retirement.**

6. **Life insurance in a qualified plan creates a problem at the time of distribution.**
3. **Life insurance in a qualified plan is too complicated to administer.**

There are rules that apply to many products, including equities, real estate, and other property held under a qualified plan when it comes to annual valuation, and more importantly handling distributions to employees. Life insurance is no different. There is a set of longstanding rules that apply to handling life insurance inside qualified plans that are tried and true…and competent administrative service providers know exactly how to handle this product.

4. **I'll just buy term insurance on the outside. It's cheaper.**

If you have a temporary need for protection, it might be better to purchase term insurance. But, when life insurance is purchased inside a qualified plan, the immediate cost to you may be no more than if you bought term insurance outside the plan. In fact, on a net after-tax cost basis, the cost may be less. This is true because the premium paid through the plan is with pre-tax money. You only have to report the current value of the cost of the pure insurance protection as imputed income in your income each year. The accumulated imputed income may be recoverable as basis later on, when you receive benefits from the plan. More importantly, permanent life insurance can be continued long after you've terminated employment or retired — when term insurance may be unaffordable.

5. **Life insurance will reduce the value of my plan at retirement.**

If you participate in a defined contribution plan (such as a profit sharing plan), the value of your account at retirement age will probably be less, since life insurance has mortality charges and investment products do not. The differences in values at retirement age are typically pretty modest, significantly less than most people would guess. There are two important points to keep in mind in this regard. First, protection and investment is not an either/or proposition. Both are important and one should not forego one for the other. Second, the mortality expenses associated with life insurance are not less expensive when paid with after-tax dollars. Insurance in a qualified plan may make it easier to meet the need for both insurance and retirement income. If you participate in a defined benefit plan, the value of your benefit at retirement will be the same, with or without insurance. To ensure that this will be the case, the plan with insurance typically requires slightly higher annual contributions. This means greater tax savings during the funding years, with no reduction in value at retirement.

6. **Life insurance in a qualified plan creates a problem at the time of distribution.**

If the distribution is to beneficiaries of a deceased participant, the value of the insured account will typically be greater than the value of the plan without insurance. In addition, favorable tax treatment results. The cash value of the policy less the accumulated imputed income will be ordinary income for tax purposes, but the rest of the death benefit will be income-tax-free. Rather than a problem, this is an advantage not available with other plan investments. When a life insurance policy is “rolled out” of a qualified plan at retirement or upon separation from service, the value of the policy will be income taxable. It would be misleading to call this a problem, however. Income taxes are also due on mutual funds, group contracts, limited partnerships, stocks, bonds, certificates of deposit and money market accounts. In fact, life insurance offers distribution strategies that are not available with these other investment products. Rather than a problem, these strategies may actually give insurance a modest advantage.

*Withdrawals may be subject to surrender charges and could have a permanent effect on the cash value and death benefit. Loans reduce the cash value and death benefit by the amount of the loan outstanding plus interest.*
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