Chapter 32. Income Replacement Life Insurance

One of the most obvious and most common purposes of owning Life Insurance is to provide immediate and substantial funds to provide income to the surviving spouse and children if the income provider should die.

This is true for families where either one or both spouses are employed. If the sole income provider dies, the need for funds to replace the lost income is obvious. It is generally difficult for a surviving stay-at-home spouse to return to the workplace at an income level equal to that of the deceased spouse. While in a two income family, the loss of one income provider means a substantial reduction in family income.

For a family that depends on a paycheck (that is, most families), the question is not whether income replacement life insurance is needed. The questions are how much is needed and what type of insurance should be owned.

The most common types of insurance are term insurance, whole life insurance, variable life insurance and universal life insurance. Term insurance typically involves less annual premium cash outlay with no return until death and no build up of cash value. Whole life, variable and universal insurance typically involves a higher annual premium cash outlay, with the opportunity to accumulate tax free or tax deferred investment savings in a policy that builds a cash value that can be accessed before death or if you cancel the policy.

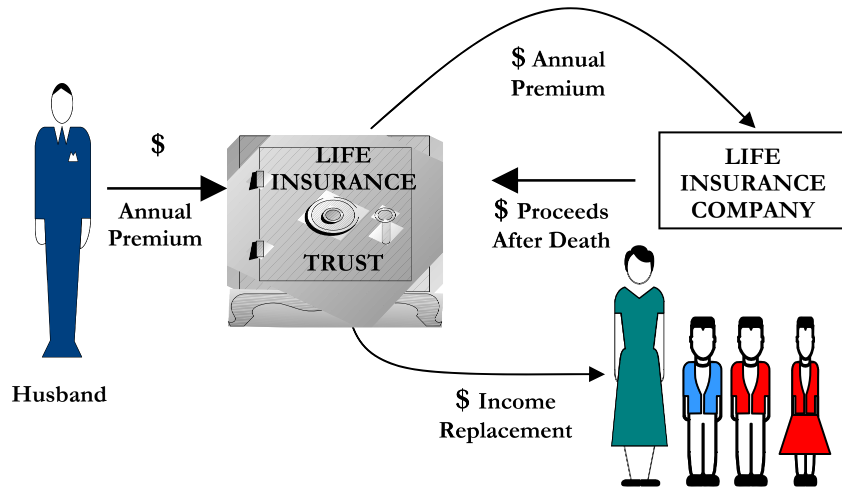
The question of how much depends on the amount of income you need to replace and how long you need to replace it for. A simple rule of thumb is you should carry life insurance at least equal to 15 to 20 times your annual after tax take home pay. This needs to be adjusted based on additional funding needed for child education expenses and other special needs.

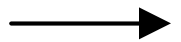
Your financial planner, investment adviser, accountant and/or life insurance adviser can provide a more detailed analysis of the type and amount of life insurance best for you.

If you've decided you don't want your Estate to go immediately upon your death into the hands of your children, then it's important to

name your Living Trust as the beneficiary of your life insurance. This enables the proceeds to be used for your surviving spouse and then be held for and/or distributed to your children at the times designated in your Trust.

Life insurance proceeds are not normally taxed for income tax purposes. However, if your Estate exceeds $5,430,000 ($10,860,000 if married) then your life insurance is generally subject to Estate Taxes -- unless you use a Life Insurance Trust as the owner and beneficiary of your life insurance.





To Do List

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