



ADVANCED INSURANCE BROKERAGE · CLIENT EDUCATION SERIES · QUALIFIED LIFE

# Life Insurance **Inside** Your 401(k)

How paying for term life insurance through your employer's 401(k) plan can cost a fraction of buying the same coverage on your own, and how to put the difference to work.

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**01**

Pre-tax vs. post-tax premiums

**02**

A \$1,000 premium, two ways

**03**

Put the savings to work

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More options and how much to own

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**\$282**

employee net cost for coverage that costs \$1,300 of pre-tax pay when bought on your own (example)

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**35–45%**

typical combined savings vs. traditional term, even with no employer match

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**\$1,018**

first-year difference that can be redirected into your 401(k)

# 01 Where the premium comes from changes what it costs

Most people pay for term life insurance with after-tax dollars. To send \$1,000 to an insurance company, they first have to earn about \$1,300, because roughly 30% goes to income tax. Inside a 401(k) plan, the same \$1,000 premium can be paid before tax.

## OUTSIDE THE PLAN · POST-TAX

### \$1,300 of pay buys \$1,000 of premium

Gross income is reduced by the tax rate (30% here), and the balance pays the policy:  $\$1,300 \times 70\% = \$1,000$  sent to the insurance company.

## INSIDE THE PLAN · PRE-TAX

### \$1,000 of pay buys \$1,000 of premium

The premium is paid from the 401(k) plan directly to the insurance company, so no income tax is taken out first.

## Three sources of savings

### ~30%

**Pre-tax or tax-deductible premium.** No need to earn extra to cover income tax (30% rate in this example).

### 5–10%

**Unisex rating.** Qualified plans use unisex rates rather than separate male and female rates; 10% is used in the example.

### Match

**Employer match.** Most 401(k) plans offer a company match, which adds further savings for the employee.

Together, pre-tax premiums and unisex rating typically save **35% to 45% compared with traditional term insurance**, before any employer match.

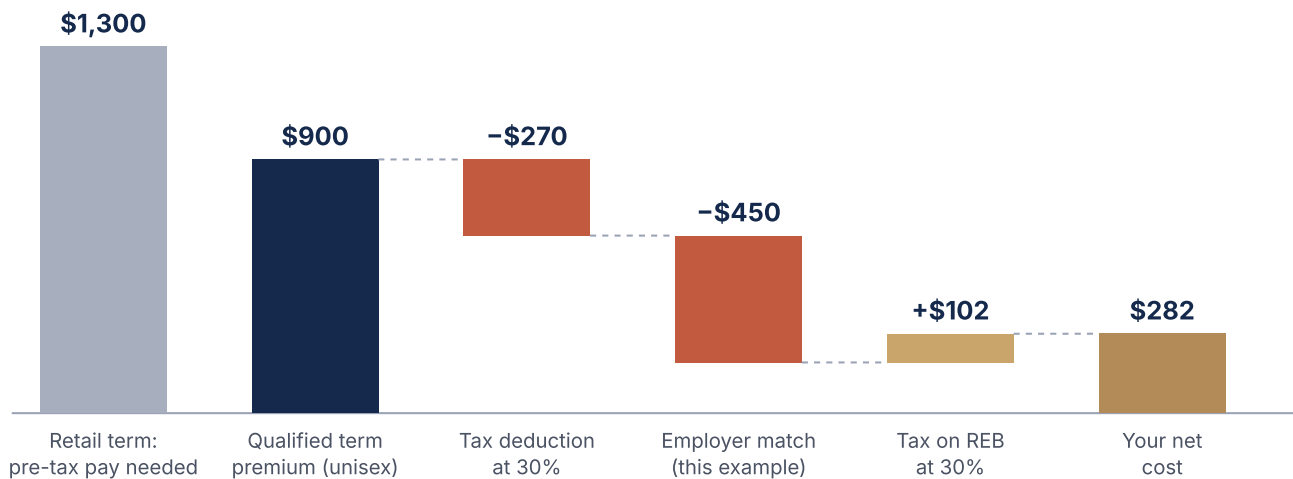
## Two ways to pay through a 401(k)

| Method                                                                                   | Tax effect                                                          |
|------------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| <b>1. Route the premium through the 401(k)</b> before it is paid to the insurance policy | Creates a tax deduction, if the plan is a traditional 401(k)        |
| <b>2. Pay the premium from the 401(k)</b> directly to the insurance policy               | Paid with pre-tax dollars, with either a traditional or Roth 401(k) |

The policy must be set up before this process begins and approved by the plan trustee, third-party administrator (TPA) or plan sponsor.

## 02 THE EXAMPLE A \$1,000 term premium, bought two ways

The same coverage, priced at \$1,000 a year on the retail market. Bought on your own, it takes \$1,300 of pre-tax pay. Bought through the 401(k) plan, the employee's net cost in this example is \$282.



Example assumes a 30% income tax rate, 10% unisex savings and an employer match that covers \$450 of the premium. Employer matches vary by plan.

| Qualified term insurance                    |              | Retail term insurance                 |                |
|---------------------------------------------|--------------|---------------------------------------|----------------|
| Qualified term premium (10% unisex savings) | \$900        | Retail premium                        | \$1,000        |
| Tax deduction on premium at 30%             | -\$270       | Before-tax (gross) cost at 30%        | \$1,300        |
| Employer match (this example)               | -\$450       | Employer match                        | \$0            |
| <b>Employee net cost</b>                    | <b>\$180</b> | Premiums are post-tax only            |                |
| Tax on REB at 30% (see below)               | +\$102       | <b>Difference vs. qualified</b>       | <b>\$1,018</b> |
| <b>Adjusted employee net cost</b>           | <b>\$282</b> | \$1,300 - \$282 = \$1,018 in year one |                |

### What is the REB?

The **Reportable Economic Benefit (REB)** is the value of the life insurance protection, calculated by the insurance company and supplied to the employer. It is added to the employee's W-2 as income. **Example:** a \$1,000,000 death benefit on a 40-year-old has an REB of about \$340; at a 30% tax rate, the employee's added tax is \$102. Reporting the REB keeps the policy's death benefit income-tax free, should a claim occur.

## 03 LOST OPPORTUNITY COST

# Put the savings to work

Buying term insurance at retail creates a **lost opportunity cost (LOC)**: money that goes to taxes and premium instead of building savings. In the example, that is \$1,018 in the first year alone (\$1,300 – \$282).

### LOC RECAPTURE

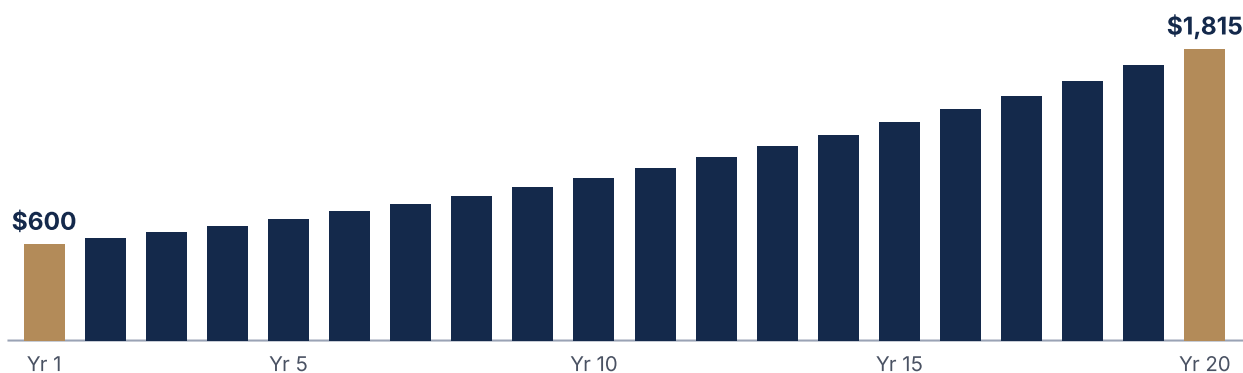
Keep contributing what the retail premium would have cost, **but put it into your 401(k)**. The recaptured savings build your account balance, with growth, and further reduce the real cost of your coverage.

## \$1,018

first-year LOC in the \$1,000 example, available to redirect into the plan

### The savings compound at your household rate

A lost opportunity cost can become an asset. In this example, \$600 saved in year one and left to grow at 6% a year becomes about \$1,815 by year 20, and keeps compounding after that.



Hypothetical: a single \$600 amount growing at 6% a year, shown at the start of each year from year 1 to year 20. Not a projection of any investment.

Every year you keep the coverage, the savings repeat. A pre-tax premium inside the plan means **more of each paycheck stays yours** and keeps compounding for your household.

## 04 MECHANICS Rules and limits for premiums

Qualified plans limit how much of your contributions can go to life insurance premiums. The limits depend on the type of policy and on whose money pays the premium.

| Type of policy                 | Annual premium limit | Based on                       |
|--------------------------------|----------------------|--------------------------------|
| Term insurance                 | 25%                  | Employee's annual contribution |
| Universal life                 | 25%                  | Employee's annual contribution |
| Whole life                     | 50%                  | Employee's annual contribution |
| Employer contributions (match) | No limit             | Any type of insurance          |

### Seasoned money: the 2- and 5-year rules

Under these rules, 100% of an employee's eligible balance can be used for qualified term premiums.

#### 2-YEAR RULE

##### Seasoned money

Employee balances that have been in the plan for more than 2 years.

#### 5-YEAR RULE

##### Seasoned participant

The employee has participated in the plan for more than 5 years.

### How the pieces fit

- The plan must allow life insurance, and the policy must be set up and approved by the plan trustee, TPA or sponsor before premiums are paid from the plan.
- Premiums can be paid with tax-deductible or pre-tax dollars, depending on the plan type (see page 2).
- The REB is reported on the employee's W-2 each year, which keeps the death benefit income-tax free.
- Contributions stay within the IRS annual 401(k) contribution limits, including the age 50 and older catch-up.

Ask your plan administrator whether your plan permits life insurance. **Advanced Insurance Brokerage can work with your employer and plan TPA** on the setup.

# 05 PLANNING More options, and how much coverage to own

## SPOUSAL OPTION

### Cover your spouse from your plan

The employee can insure a spouse and pay the premium from his or her 401(k). Attractive for dual-income households.

## CONVERSION

### Convert to a permanent policy

Term coverage can be converted to permanent insurance during a 10- or 15-year period, valuable if health changes, for the employee or spouse.

## BUSINESS OWNERS

### Business planning

Key employee coverage and buy/sell agreement funding with tax-deductible or pre-tax dollars.

## IRA TRANSFER

### Move an IRA into the 401(k)

IRA assets transferred into a 401(k) plan can be 100% available for insurance premiums, which may help cash flow or net cost.

Qualified Life can also use permanent policies (whole life and universal life), subject to the limits on page 5.

## How much coverage? Two phases

Coverage needs change over a lifetime. An example household:

| Phase 1 · Building (about 30 years)           |                    | Phase 2 · Transferring (20–30 years)       |                  |
|-----------------------------------------------|--------------------|--------------------------------------------|------------------|
| Income replacement: \$100,000 × 20 years      | \$2,000,000        | Income tax on \$1M of 401(k)/IRA at 35%    | \$350,000        |
| Outstanding debt: mortgage, credit            | \$300,000          | Capital gains tax: 20% on \$200,000        | \$40,000         |
| College, optional (about \$100,000 per child) | —                  | State and federal estate tax, if triggered | \$0              |
|                                               |                    | Convalescent care: about 1 year            | \$100,000        |
| <b>Phase 1 total</b>                          | <b>\$2,300,000</b> | <b>Phase 2 total</b>                       | <b>\$490,000</b> |

Phase 2 assumes a non-spouse beneficiary. Estate taxes apply only above state and federal exemption limits (for example, Illinois above \$4 million at up to 16%; federal up to 40%).

Phase 1 needs shrink as income years and debts wind down. Phase 2 needs can be smaller or larger. **A common mistake is letting term coverage end just as you get closer to needing it;** conversion and permanent options help keep protection in place.

## IMPORTANT DISCLOSURES

# Please read

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**Educational purpose.** This brochure is for general educational purposes. It is not a recommendation to buy any insurance product or to take any action within a retirement plan, and not a statement that any strategy is suitable for you.

**Hypothetical example.** All figures are hypothetical and illustrative. The \$1,000 premium example assumes a 30% income tax rate, 10% unisex rating savings and an employer match covering \$450 of premium. Your premiums, tax rate, plan provisions and employer match will differ.

**Plan provisions.** Not every 401(k) plan permits life insurance. Purchasing insurance in a qualified plan requires plan approval and must follow the plan document and IRS rules, including incidental benefit limits on the share of contributions used for premiums. Consult your plan administrator.

**Reportable Economic Benefit.** The cost of current life insurance protection (REB) is reportable as taxable income to the participant each year. REB amounts are calculated by the insurance company and vary by age, death benefit and carrier.

**Growth example.** The \$600 compounding example uses a hypothetical constant 6% annual rate for illustration only. It does not represent any investment and does not reflect fees or taxes. Actual results will vary.

**Insurance.** Insurance products are offered through Advanced Insurance Brokerage. Life insurance requires underwriting. Guarantees are based on the claims-paying ability of the issuing insurer. Conversion privileges are subject to the terms of each policy.

**Not tax or legal advice.** Advanced Insurance Brokerage does not provide tax or legal advice. Tax laws, contribution limits and estate tax exemptions change. Consult your tax advisor or attorney about your situation.



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