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Managing your tax bracket

Life insurance to protect against tax rate ups and downs

It's always important to diversify and spread your risk among many investments. Diversification can help protect you from fluctuations among different assets and asset classes.[1]

But what about diversifying your tax rate exposure?

By diversifying among different financial products, you may have the ability to protect yourself against fluctuations in tax rates. Why is this important? During years with high tax rates, you may want to have the option to take funds from tax-free investments. In today's uncertain tax and budget environment, planning for this is all the more important.

The problem

Rosie and Bennett are a middle-aged couple. They're saving for retirement, but need to care for their children and plan for college. Bennett is also looking at life insurance to help protect the family in case something happens to him. At the same time, the couple is funding their IRAs and 401(k)s, but know these won't address all they need for retirement.

The possible solution

Carl, their financial professional, shows them an option — cash value life insurance. It offers Rosie and Bennett:

- Death benefit protection in case something happens to Bennett during his working years.
- Access to policy-available cash surrender values that grow tax-deferred.
- During the couple's retirement years, any available cash surrender value can be taken from the life insurance policy via withdrawals and loans. So long as the life insurance remains inforce, the funds can be received income tax-free.
- The couple can use these tax-free withdrawals and loans to supplement income in years they need added income without increasing their tax bracket.[2]
- Withdrawals and loans from life insurance policies are exempt from the 3.8% Medicare surcharge.

A final added benefit

Life insurance cash values, along with the couple's IRA and 401(k) accounts, aren't included in the expected family contribution calculations for college financial aid.

Meet Rosie and Bennett

- Need life insurance
- Think taxes will increase
- Need more retirement income than Social Security, their IRAs and other current savings can provide
- Already maximum funded

1 Diversification is a method of asset allocation. It does not guarantee a profit or protect against a loss. A diversified method of investing may result in a loss of principal to the investor.

2 Loans and withdrawals reduce the policy's cash value and death benefit, and increase the chance the policy may lapse. If the policy lapses, terminates, is surrendered or becomes a modified endowment, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distributions of policy cash values.

Managing your tax bracket

Rosie and Bennett have a number of sources of income to meet their $125,000 target income, but they're worried about taxes. Each year they will take nondiscretionary payments, such as Social Security and their required distributions, from taxable retirement funds. This fills up their lower tax brackets, totaling $89,450 and paying $10,294 in taxes.

Added benefit with life insurance

With life insurance, the funds can be pulled out free of income taxes. The couple has the option to withdraw or borrow less, and still meet the same after-tax amount they need to live on.

The chart shows how Rosie and Bennett fill their higher tax brackets.[3] Once they take $89,450 in income, the next dollar they take will be taxed at 22%. They need an additional $35,550 to meet their income goal of $125,000. They will pay $7,821 in taxes if they take the $35,550 from taxable income (IRA, pension distributions, other taxable income). They will pay $0 in taxes if they take the $35,550 from nontaxable income (life insurance cash value, Roth IRA and municipal bond interest).

		Lower tax brackets filled first: Social Security, IRA and pension distributions, and other taxable income			**Higher tax brackets:** Rosie and Bennett have a choice — taxable income, cash values, Roth IRAs and municipal bond interest		**Total**
		First $22,000	+	Next $67,450	+	Next $35,550	=	$125,000
Without life insurance planning	Tax rate	10%		12%		22%		
	Taxes due	$2,200	+	$8,094	+	$7,821	=	$18,115
Compare		**$89,450 taxable**			**$35,550 nontaxable**			**Total**
		First $22,000	+	Next $67,450	+	Next $35,550	=	$125,000
With life insurance planning	Tax rate	10%		12%		0%		
	Taxes due	$2,200	+	$8,094	+	$0	=	**$10,294**
						43% savings	=	**$7,821**

Some considerations before moving ahead:

Carefully review all the features, benefits and costs of a cash value life insurance policy with your financial professional before making a purchase. There are many other differences between Roth IRAs, municipal bonds and permanent life insurance.

- If your life insurance policy lapses, you will lose the death benefit and may lose substantial money in the early years.
- To be effective, you need to hold the policy until death. A life insurance policy generally takes years to build up a substantial cash value.
- Tax-free distributions will reduce the cash value and face amount of the policy. You may need to pay higher premiums in the later years to keep the policy from lapsing.
- You must qualify medically and financially for life insurance.

3 Assumes tax calculations made for tax year 2023, married filing jointly.

Why Equitable?

Our Advanced Markets experts meet the changing needs of clients with complex challenges through powerfully simple strategies, including:

- Strong life insurance portfolio with competitive cash value product options.
- A wide selection of riders to choose from, including the Charitable Legacy Rider®, which offers an additional death benefit to the charity(ies) of your choice at no added cost.
- Strength and stability. For more than 160 years, we've been working with clients across generations, building on what's proven and pursuing what's possible.

To learn more, call your financial professional or visit equitable.com.

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