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VantagePoint℠ Term Life Insurance Offers Tax Advantages

VantagePoint℠ Term Life Insurance with Return of Premium[1] offers tax advantages of which few people are aware. If policyowners keep policy in force until the end of the ROP term, they have essentially paid for their life insurance coverage with untaxed values.

With the return of premium (ROP) feature of the VantagePoint Term Life Insurance policy, premiums will be returned to the owner at the end of the initially selected 15, 20, or 30 year guaranteed level premium period.[2] To aid in our discussion, we shall assume Jack, age 45, purchases a twenty-year VantagePoint policy.

Example 1. *Jack is a 45-year old male rated as a Preferred No-Nicotine Use insurance risk. Jack purchases a $1,000,000* VantagePoint *twenty-year level premium period (annually increases thereafter) term life policy (since this effects the premium amount) with the Basic Cash Value Rider. His annual premium is $4366. At the end of the twentieth year, Jack's ROP benefit returns to him an amount equal to the premiums he paid for the policy, $87,320 ($4366 times 20). This "return of premiums" raises the following question, however.*

Since Jack received all of his premium back, what was the actual cost of the term life insurance during the twenty-year coverage period? The amount Jack "paid" for the coverage is equal to the time value of the premium – that is, what Jack might of earned had he invested the money instead of purchasing the life insurance. Looking at it from another perspective, if Jack paid $87,320 in total premiums and received that same amount back at the end of the twenty years, the only thing the insurance company received for providing twenty-years of life insurance coverage is what it earned by investing the premiums Jack paid.

Was Jack ever income taxed on this time value of the premiums he paid to the insurance company for his coverage? No. The interest that the insurance company earned on the paid premiums was interest that Jack might have earned had he invested the dollars instead of purchasing life insurance. Had Jack invested the money he would have had to pay income tax on the earnings. However, this amount was invested by the

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insurance carrier instead and therefore, not income taxable to Jack. Therefore, Jack paid for the term life insurance coverage **with the insurance company's earnings which are not taxable to Jack.**

How do you determine the financial benefit Jack received from paying for his life insurance with values that were never income taxed? One way to estimate the benefit of paying with "untaxed dollars" would be to compare obtaining the same benefits for Jack with dollars that are taxed. For example, one could purchase a very competitive 20-year term life policy and try to accumulate $87,320 (on an after-tax basis) with the difference between the lower term policy premium and the higher VantagePoint ROP term policy premium. Jack's tax income tax bracket will affect the calculation.

Example 2. *Jack is a 45-year old male rated as a Preferred No-Nicotine Use insurance risk. His combined state and federal income tax rate is 32%. With Genworth Life's SureTerm® 20, a highly competitive 20 year term life policy, his annual premium for a $1,000,000 VantagePoint twenty year level premium period (annually increases thereafter) term policy would be $1490 with no return of premium (ROP). Since this effects the premium amount with the* VantagePoint 20 year term life policy accompanied by the Basic Cash Value Rider*, his annual premium for $1,000,000 of life coverage is $4366.*

The $2876 difference in annual premium outlay ($4366 - $1490 = $2876) is largely due to the ROP feature of the VantagePoint *policy. With the ROP feature, the $87,320 he paid in premiums will be returned to him at the end of the twentieth year… if living. In other words he must pay an additional $2876 per year (a total of $57,520 over 20 years) in order to receive the return of the $87,320 in premiums he paid.*

To compare VantagePoint ROP with "buying Sure Term® and investing the difference," Jack would have to contribute $2876 annually to a sinking fund and see if he can accumulate more than $87,320 in twenty years. Jack's income tax bracket and assumed rate of return on the sinking fund will largely determine the results.

The ***after-tax*** rate of return that Jack would have to earn on his annual $2876 deposits to accumulate $87,320 in twenty years is equal to 3.83%, compounded annually. The ***before-tax*** rate of return Jack would have to earn on his annual $2876 deposits to accumulate $87,320 in twenty years is equal to 5.63%, compounded annually.[3]

AAA rated twenty year corporate bond yields are currently about 5.3%. Does that mean Jack is better off by purchasing* VantagePoint *with the ROP rider than by purchasing Sure Term® and investing the difference in twenty year corporate bonds? No. Remember, the return of premium feature is not an investment. Bonds are investments that may provide current income, be sold for cash needs, and be used as collateral. The return of premium rider has none of these features. Rising or falling interest rates or markets will not affect the amount Jack receives from his ROP feature. If Jack dies, the ROP rider pays nothing and does not increase his death benefit. However, the VantagePoint ROP feature may make financial sense for the prospect that has the right liquidity, tax, and investment risk profile, as indicated by the rate of return calculations above.

Does the insured's age and insurance rating make a difference in the attractiveness of the ROP feature? Yes, results vary on a case-by-case basis. However, the ROP feature may be more attractive for certain higher risk insureds. Let's apply the above analysis to a Male age 50 smoker.

Example 3. *Joe is a 50-year old male rated as a Standard Nicotine Use insurance risk. His combined state and federal income tax rate is 32%. With Genworth Life's Sure Term 20, a highly competitive 20 year term life policy, his annual premium for a $1,000,000 VantagePoint twenty year level premium period (annually increases thereafter) term policy would be $10,380 with no return of premium (ROP) feature. Since this effects the premium amount with the VantagePoint 20 year term life policy accompanied by the Basic Cash Value Rider, his annual premium for $1,000,000 of life insurance coverage would be $24,684.40. The difference in annual premium between the two policies is $14,304.40. With the* VantagePoint *ROP feature, the $493,688 he will have paid in premiums will be returned to him at the end of the twentieth year.*

To compare VantagePoint ROP with "buying Sure Term® and investing the difference," Joe would have to contribute $14,304.40 annually to a sinking fund and see if he can accumulate more than $493,688 in twenty years.

The ***after-tax*** rate of return that Joe would have to earn on his sinking fund (annual $14,304.40 deposits) to accumulate $493,688 in twenty years is equal to 4.95%, compounded annually. The ***before-tax*** rate of return Joe would have to earn on his sinking fund (annual $14,304.40 deposits) to accumulate $493,688 in twenty years is equal to 7.28%, compounded annually.

With VantagePoint, Joe's payment to the insurance company by the end of the twenty year period might be characterized as his forgone interest of 7.28%.

If Joe dies during the twenty-year coverage period, does the "buy SureTerm and invest the difference" strategy provide more financial benefits to the beneficiaries than the *VantagePoint* strategy? Yes. With the Sure Term strategy, the beneficiaries receive the face amount of the policy plus the sinking fund. With the VantagePoint strategy, the beneficiaries receive just the face amount of the policy. However, r*emember, during the twenty-year period, Joe is either going to live or going to die*.

If Joe dies, the death benefit represents a large return on the premium he paid whether he used the Sure Term product or the VantagePoint product.

If Joe lives and has the Sure Term product, Joe receives no return of premium and has only his sinking fund. If Joe lives and has the VantagePoint product, he receives all of his premium back, $493,688.

Sure Term® 5/10/15/20/30 is term life insurance with guaranteed level premiums for 5, 10, 15, 20, or 30 years. After the level premium period, Premiums are not guaranteed and increase annually. Subject to the terms of Policy Form No. GE-1420 et al. Includes $50 annual policy fee. Issue age is insured's age at nearest birthday. Subject to state availability and issue limitations. Rates for the premiums shown are effective as of 8/1/2005. Premiums may be paid annually, semiannually, quarterly or monthly (by pre-arranged withdrawals only). For non-annual payments spread throughout the year, we adjust the premium by a modal factor. These factors and corresponding APRs are .51 for semi-annual (8.2%), .26 for quarterly (10.8%) or .0875 for monthly (10.8%). The yearly premium cost will be higher if paid semiannually, quarterly or monthly. In certain instances, face amounts near the upper part of a band may have higher premiums than the minimum face amount of the next higher band. As always, we rely on you to ensure that your client is making a suitable choice. Sure Term® 5/10/15/20/30 term life insurance is underwritten by Genworth Life, Lynchburg, VA.

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[1] Return of premium is provided by a Cash Value Rider. The rider provides a benefit at the end of the initial premium period equal to all premiums, less any flat extra premium and outstanding loan amounts. After the fourth policy year and before the end of the initial premium period, the rider provides cash value benefits that are less than the amount of premiums paid. No cash value benefit is paid at the insured's death, only the policy face amount. For more details see the VantagePoint℠ Rates and Product Features brochure, 1RB0078 0106. Subject to the terms, issue limitations and conditions of Policy Form Nos. TLNCVFCL05 et al. for First Colony Life and TLNCVGE05 et al. for Genworth Life. VantagePoint℠ term life insurance, as well as its benefits and riders, may not be available in all states.

No changes to rate classification, amount of insurance or additional riders after the policy is in force. There is not additional charge for paying more frequently than annually. Rates for the premiums shown are effective 10/25/2005. Includes $60 annual policy fee.

Generally Return of Premium products cost more than products without this feature. Products with reduced underwriting requirements usually cost more than products with additional underwriting requirements.

[2] Riders do not provide any additional death benefit. If the insured dies before the end of the level period, only the death benefit is paid.

[3] Jack paid an additional $2876 per year for twenty years to receive a $87,320 lump sum at the end of the period. Since we know the future value of the payments ($87,320) and the stream of payments it took to create the lump sum ($2876 per year for a total of $57,520), it is easy to calculate the interest rate that would have been necessary to create the final lump sum of $87,320 using the financial function on a hand calculator. However, the formula may be expressed as thus:

$FV = PMT \bullet [((1+ i)^n – 1) / i] (1 + i)$

Where: FV = future value

PMT = annual payment

i = after tax interest rate = $i^b (1- TB)$

i^b = before tax interest rate

TB = taxpayers combined federal and state income tax bracket.

The interest rate is approximately 3.83% after tax or 5.63% before tax.