

# Frequently Asked Questions



## *Life Insurance*

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### **How much life insurance should an individual own?**

Rough “rules of thumb” suggest an amount of life insurance equal to 6 to 8 times annual earnings. However, many factors should be taken into account in determining a more precise estimate of the amount of life insurance needed. Important factors include income sources (and amounts) other than salary/earnings, whether or not the individual is married and, if so, what is the spouse’s earning capacity, the number of individuals who are financially dependent on the insured, the amount of death benefits payable from Social Security and from an employer-sponsored life insurance plan, whether any special life insurance needs exist (e.g., mortgage repayment, education fund, estate planning need), etc.

### **What about purchasing life insurance on a spouse and on children?**

In certain circumstances, it may be advisable to purchase life insurance on children; generally, however, such purchases should not be made in lieu of purchasing appropriate amount of life insurance on the family breadwinner(s). In a dual-earning household, it is important to protect the income earning capacity of both spouses. Life insurance on a non-wage earning spouse is often recommended for the purpose of paying for household services lost at this individual’s death.

### **Should term insurance or cash value life insurance be purchased?**

Several principles should be followed in addressing this issues. It must first be recognized that in any life insurance purchasing decision, there are at least two basic considerations: how much and which type. The amount of life insurance that you need may be so large that the only way in which this can be afforded is through the purchase of term insurance with its lower premium. If your ability to pay life insurance premiums is such that you can afford the desired amount of life insurance under either type of policy, you will need to decide which type to buy. Important factors affecting this decision include your income tax bracket, whether the need for life insurance is short-term or long-term, and the rate of return on alternative investments possessing similar risk.

### **How does mortgage protection insurance differ from other types?**

The face amount under mortgage protection term insurance decreases over time, consistent with the projected annual decreases in the outstanding balance of a mortgage loan. Mortgage protection policies are generally available to cover a range of mortgage repayment periods. Although the face amount decreases over time, the premium is usually level in amount. Further, the premium payment period often is shorter than the maximum period of insurance coverage.

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### **Can an existing life insurance policy be used to provide for the repayment of an outstanding mortgage loan?**

Yes, an existing policy, either term or cash-value life insurance, can be used for many purposes, including paying off an outstanding mortgage loan balance in the event of the insured's death.

### **What is the tax treatment of life insurance cash values, dividends, and death benefits?**

The "interest build-up" portion of the annual increase in the policy's cash value is not taxed currently to the policy owner. Dividends generally are considered to be a "return of premium" and are not taxable to the policy owner. Although in the typical case, life insurance death proceeds will not be subject to income taxation, these proceeds may be subject to federal estate taxation. If the insured has any elements of ownership in the policy at the time of his/her death, the proceeds are includible in the insured's gross estate for federal estate tax purposes. State inheritance taxes and federal gift taxes may also apply to life insurance policies/proceeds under specific circumstances.