

PERSONAL FINANCE; USING LIFE INSURANCE AS A TAX SHELTER

By DEBORAH RANKIN

WHILE the recent Tax Act effectively axed many tax shelters, it hardly touched the tax breaks provided by life insurance. In particular, the single-premium policy has emerged as a popular tax-advantaged investment: You make a single payment up front - usually a minimum of \$5,000, but in practice often \$50,000 or \$100,000 or more - that buys you a chunk of life insurance and an investment fund that appreciates tax-free as long as you keep the policy in force.

There are two basic types of contracts. In a single-premium whole-life policy, the insurer guarantees your principal. Some companies fix the initial return - current rates range from 7 to 8 1/2 percent - for a given duration, usually one to three years. After that, returns fluctuate at the company's discretion, although they are supposed to reflect prevailing market rates. Other companies quote their current dividend schedule, but rates are not guaranteed, and may fluctuate monthly.

In a single-premium variable policy, you decide how your funds are invested, choosing from the company's menu of stocks, bonds and mutual funds. And you bear the risk: If your investments prosper, so does your cash value; if not, you can suffer a loss of principal.

Apart from tax advantages, liberal loan provisions, allowing you to borrow at a net cost of zero to two percent, make single-premium policies attractive. You can often borrow up to 90 percent of a policy's cash value tax-free. You need never pay back the loan. But at your death, it will be deducted from the proceeds paid to your beneficiaries.

Borrowing privileges make single-premium policies a convenient way to save for a child's college education. For example, a 35-year-old man who invests \$29,365 with the Northwestern Mutual Insurance Company today at a net rate of 8.72 percent would get a policy with an initial death benefit of \$150,000; after 15 years (assuming the same rate of return) the insurance would swell to \$272,632. The cash value would rise to \$102,956 - a nest egg that could be tapped for tuition bills. An additional benefit: The value of the policy is not counted by the Government (and often not by the college) when figuring whether a child is eligible for student aid.

Single-premium policies are also pitched as a way for retirees to increase their tax-free estate, and still have access to their money. For example, a 60-year-old woman who pays a \$25,000 premium today with the USAA Life Insurance Company would get a policy with an initial death benefit of \$54,500; after 10 years, at a net return of 8.81 percent, the cash value of the policy would stand at \$58,179 and the insurance portion at \$67,488. Any money received from a policy loan would not affect the taxability of Social Security benefits.

But single-premium policies may be sowing the seeds of their own destruction. Some insurers are paying a lower interest rate on these popular policies than on those that require annual premiums. And many analysts worry that Congress may crack down on the liberal borrowing provisions.

"I consider the purchasers of single-premium whole life to be speculators," Glenn Daily, an insurance analyst with Seidman & Seidman Financial Services, warned recently in the journal of The American Association of Individual Investors. "They are speculating that favorable tax treatment will continue or that existing policies will be fully shielded from future tax law changes." One rule of the game is that the rules can change, he added.

Mr. Daily and others warn that Congress may decide to treat policy loans as taxable distributions, on a par with distributions from pension plans and Individual Retirement Accounts.

But other experts say that the attractive returns, combined with the tax-free buildup on the cash value, make a single-premium policy a good investment without the loan feature - and even without the death benefit. "You might want to buy one of these even if you don't want the insurance," said James Hunt, an independent actuary and former Vermont insurance commissioner who is also a director of the National Insurance Consumer Organization (N.I.C.O.). CHOOSING the best single-premium policy can be a daunting task. Companies design their products in different ways, making exact comparisons difficult. In particular, some companies quote "gross" interest rates (ones that do not take mortality charges and other expenses into account) while other companies quote their rates "net" of such charges.

Mr. Hunt of N.I.C.O. agreed to compare interest rates and the buildup of cash values and death benefits among single-premium policies offered by five insurers. Three companies - E.F. Hutton, Northwestern Mutual and USAA - quickly provided the requested information for two hypothetical examples, one for a 35-year-old man, the other for a 60-year-old woman. Their net rates of return, as computed by Mr. Hunt, were closely bunched, ranging from a high of 8.81 at USAA Life to a low of 7.75 percent at Hutton.

But two other companies - Massachusetts Mutual and Equitable - set up stumbling blocks. Mass Mutual said it does not furnish information for illustrative examples, but disclosed that, effective last Monday, it was initiating a policy of paying purchasers of single-premium policies "an internal rate of return that was about three percentage points less than the rate of return paid to purchasers of an annual premium policy." (Northwestern Mutual, which has had a similar policy for some time, pays single-premium purchasers two percentage points less than owners of annual premium policies.) Equitable said it could not furnish the information requested within our deadline. However, insurance experts advised that such information can be obtained quickly by company agents for potential customers. Telephone calls to two Equitable agents selected at random from the telephone book turned up answers in 10 minutes: One agent said the net rate of return was 7.25 percent, the other said 7 percent. Questioned about the discrepancy, an Equitable spokesman said 7 percent was the correct rate for policies with premiums between \$5,000 and \$249,000.

To obtain more specific information, consult your telephone directory: Local agents are listed under the names of the major insurers. USAA Life, based in San Antonio, sells only through the mail and by telephone; outside Texas, its toll-free number is 1-800-531-8000.

To eliminate the chore of comparing dissimilar policies, write to N.I.C.O. at 121 North Payne Street, Alexandria, Va. 22314. Its fee for determining the true rate of return on policies with different premium amounts is \$25 for the first policy analyzed and \$20 for each additional one.