Practical Applications of Annually Renewable Term Life Insurance

Annually renewable term life insurance can be an ideal option for dealing with uncertain risks of temporary duration. The problem is that most term policies are issued for periods of 5 to 30 years in 5 year increments. This approach to policy design does not most efficiently address the needs of those customers that face risks that are not matched to a period of 5 years or multiples thereof. For example, a parent with a child going to college might want to buy an annually renewable term policy to cover the risk of their death during the period that the child is in school. The problem is that a college education typically lasts four years and to match that period of risk the parent may want coverage for a four-year policy. Unfortunately, if the parent is forced to go to a five year policy they may end up paying for an extra year of coverage they don’t need or want.

The answer to this and similar situations is to create an annually renewable term product that permits the customer to select their coverage in periods of other than five-year increments. Specifically, it would allow the customer to choose a period of coverage that precisely matches the duration of their risk exposure such as four years in the above example. Other examples of needs that could be more efficiently addressed by a contract that let the customer pick the period of coverage are as follows:

**Estate Planning**

Sale to a grantor trust – In those situations where a customer establishes a grantor trust and sells property to the trust for installment notes the customer bears the risk that if they die before all the installments are paid any outstanding notes will be included in their gross estate. Consequently, if the inclusion of such notes would generate an estate tax liability the customer should consider purchasing an annually renewable term policy for the duration of the notes.

Gifting Family Limited Partnership or LLC interests – Some customers establish Family Limited Partnerships or LLCs and transfer business or property interests to such entities for purposes of implementing gifting programs that utilize discounts for lack of marketability and lack of control. Sometimes the value of the discounted FLP or LLC interests are so large that even after utilizing the customers applicable gift tax exclusion the customer must continue gifting in future years using the annual gift tax exclusion to dispose of all their FLP or LLC interests. This means that if the customer dies before gifting all of their FLP or LLC interests such interests may generate an estate tax. To cover that possibility the customer may purchase annually renewable term insurance in an amount large enough and for duration long enough pay any potential estate tax.

Grantor Retained Annuity Trust – If a customer transfers property to a GRAT in return for an income interest and dies before the income period runs out the trust property will be brought back into their gross estate. In those situations where the inclusion of the property will generate an estate tax the customer should consider purchasing annually renewable term coverage in an amount large enough to cover any potential estate tax. Of course, the coverage should be bought for a period of years long enough to cover the customer’s income interest.

IRC 2035 Three year rule – If a customer transfers a policy on their life to a third party and they die within three years of making the transfer the death proceeds will be included in their gross estate. To deal with this risk of estate inclusion and any related tax it would generate the customer should consider purchasing an annually renewable term policy in an amount sufficient to pay the potential tax. Further, since the tax exposure is for a period of three years the policy should be for duration of three years.

**Domestic Relations**

Alimony – If one of the parties to a divorce is required to pay alimony for a specific number of years they should be required as a part of the decree or separation agreement to purchase annually renewable term coverage in an amount large enough to cover their payment obligation. Here again, the length of the policy’s duration should match the number of years for which the alimony is to be paid.

Child support – If a child support obligation is for a certain number of years the responsible parent should purchase annually renewable term policy in an amount large enough and for a period long enough to match the obligation.

**Business Insurance**

Key person – If a business owner has an employee that is crucial to the company’s profitability that employee should be insured for an amount sufficient to cover any lost income and increased expenses that would be associated with the employee’s death. An annually renewable term policy would be suitable for this purpose if it provides coverage for duration equal to the number of years for which the employee’s services would be needed or possibly as a stop-gap while permanent insurance solutions are contemplated.

Contract protection – Should a business enter into a contract the performance of which is tied to the services of a particular individual that individual should be insured in an amount sufficient to cover any losses that would be associated with their death and non-performance of the contract. Annually renewable term insurance should be considered for this purpose and it should be of a duration long enough to match the timing of performance under the contract.

**Debt Obligations**

Term loans – If a personal or business debt is of a specific duration an annually renewable term policy should be considered to guarantee the payment of the obligation. The duration of the coverage should match the length of the obligation.

Demand loan – Should a personal or business debt be of a demand loan nature the obligor should be insured for the amount of the debt with an annually renewable term policy in duration as long as the debt might be expected to be outstanding.

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