

Episode #312: Turning Compounding Interest Into a Tax-Free Gold Mine

Hello and welcome to another episode of Money Script Monday. My name is Luke Geller, and today we're going to be talking about turning compounding interest into a tax-free gold mine. I'm going to start off today by giving you a choice. On one hand, I have a million dollars, cold hard cash that you can have right now. On the other hand, I'm going to give you 1 penny, and with that penny, I'm going to double it every single day for a month. So, which one would you rather have?

Some of you might have had this choice given to you before because it is pretty common and if you break it down and think about it well, \$1,000,000 right now sounds pretty good, right? But when you take a look at the math and break down what a penny doubled every day would be, well, after seven days you have about 64 cents. It's not very much. We go out 15 days, you finally break \$100. That's still not close to \$1,000,000, but we're getting up there.

Then after three more days, on day 18, you break \$1,000. So, it went from \$100 to \$1,000 pretty quickly. Then finally, at day 28, you break a million, so you're over \$1,000,000 after 28 days. If we go to day 31, you have over \$10 million that you would have if you chose to double a penny every single day.

That's pretty powerful. What we're talking about is the power of compounding interest. Today I want to talk about a retirement vehicle called Indexed Universal Life. We're going to touch on the power of compounding interest inside that vehicle as well as the tax advantages of that vehicle.

When we look at the power of compounding interest, Albert Einstein said compounding interest is the eighth wonder of the world. Those who understand it earn it, and those who don't, pay it. Credit card companies

love those who don't understand it, right? That is what compounding interest is, when you owe a lot of money on your credit cards, and that's why credit card companies and banks love you to take out more credit.

But the opposite can be said. How can we use this to your advantage? Let's look at a vehicle where we can take advantage of what compounding interest does. First, I want to look at the rule of 72, which is how do we know that when we took that penny, we doubled it every single day? Now, you're not likely to double your money every single day. That would be amazing, but what we can do is we can use the rule of 72 to determine how long it would take to double your money.

The rule of 72 states that if you know either the length of time or the interest earned, you can find out how long it would take or how much you would need to double your money. For example, if you know you want to double your money in 10 years, you divide 72 by 10, which gives you 7.2. So, if you earn 7.2% for 10 years, you would double your money. And vice versa, if you know that you can earn 10%, then you know it would take 7.2 years to double your money by earning 10%. Which is pretty powerful to know. Let's take this information, the power of compounding interest, knowing that your money is doubling and that your money is earning money as it grows, and looking at some of the tax advantages that you have in life insurance.

Today, we're going to look at two different tax advantages in life insurance. Now there are three total. The first one is the tax-free benefit of the death benefit but we're not going to talk about that today. We're going to focus on the tax-deferred interest and the tax-free loans. Those are two tax advantages that you have in any cash value policy.

The reason that tax-deferred interest is so powerful is because of compounding interest because you want uninterrupted compounding interest. When we look at tax-deferred growth, you're having uninterrupted

growth on that money. You don't want to earn money and then have to pay taxes on some of that as well, right?

Then you have tax-free loans. So, when you finally grow that money and you decide to take some of that out, you don't have to pay taxes on that either. How is that possible inside life insurance? It's with these codes here. 7702 defines exactly what a life insurance policy is and how it needs to be structured in order to get these tax advantages. Then 72e states that you have the ability to take those tax-free loans from your life insurance policy. We looked at the power of compounding interest and looked at these two tax advantages that you get inside of life insurance. In an indexed universal life, you have the power of compounding interest inside.

Let's take a look at a case study and what that does. In this case study, we had a 40-year-old male. Now that 40-year-old male put away \$6,500 a year every single year until retirement, he retires at age 65. He put his hard-earned money inside this indexed universal life policy for 25 years and with that tax-deferred growth, he was able to grow that money to \$405,000, actually a little bit over that. Now he has \$405,000 in cash value inside his indexed universal life policy. He was able to grow that using the power of compounding interest and the power of tax-deferred growth.

Now in an IUL policy, it's more of a moderate, modest growth, we're not trying to get 10, 20, or 30 percent. We actually illustrate indexed universal life policies at around 6%. We know using the rule of 72, it'll take about 12 years for your money to double. For this individual, his money kept growing, it kept doubling, and he grew that to \$405,000 plus.

He retired at 65 with that much money, and now it's time to take these tax-free loans and take advantage of that. At his life expectancy over the next 20 years, while he's retired, he took a total of \$730,000 in tax-free loans out to help pay for any retirement expenses that he had on top of anything else he had as well. Again, this was only putting in \$6,500 a year, which is about \$162,000 in total.

This individual put \$162,000 into an indexed universal life policy, used the power of compounding growth and tax-deferred growth to grow that to \$405,000, and then again, used the power of compounding interest while taking loans out of the policy and utilizing 72e to take tax-free loans. So, now he took out \$730,000 in tax-free loans in retirement, and again, we didn't talk about the death benefit or any of those additional factors that this client has.

Today we talked about the power of compounding interest, talked about the different tax advantages in life insurance, and we looked at a case study where an individual took advantage of both of those tools. I hope that by watching today, you were able to take and understand a little bit more about compounding interest, learn a little bit more about the rule of 72 and how that works as the eighth wonder of the world, and then also learn a little bit more about the tax advantages in life insurance and indexed universal life. My name is Luke Geller, and we appreciate you being here for today's episode of Money Script Monday.