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Should I buy life insurance for kids?

Q. My friend's son is selling insurance, and he's offering me whole life policies for my kids, who are 5, 3 and 1. The policies are cheap — about $250 a year for a $50,000 benefit. Should I do it?
— Mom

A. Life insurance is typically purchased for two reasons: income replacement and costs associated with death such a funeral and burial or estate taxes.

In the case of a child, there isn't a need to replace income, but if the policy fits in the family's budget and there is a risk that there might not be the funds to pay for a funeral, then there is some merit to considering the purchase of a life insurance policy, said **Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge**.

But when thinking about insurance for children, Mott said, there are two other reasons that are often considered: the child's future insurability and funding college costs.

"Once an insurance policy is put in force, a change in the child's health status or development of a medical condition will not jeopardize its continuation," she said. "This may also include a future diagnosis that involves medications which result in higher premiums or being denied coverage completely."

Mott said a permanent insurance policy will likely accumulate cash value as the years go by. This can be a source of funds to help cover college tuition and other expenses.

"Cash value can be accessed directly as a withdrawal or it can be borrowed in the form of a policy loan," she said. "But, it is essential to understand the costs associated with both withdrawals and loans."

Mott said cash value distributed in excess of paid-in premiums will be taxable as income to the child. This may jeopardize other financial aid and may result in a "kiddie tax" where a child's income in excess of $2,100 (for 2016) is taxed at the parent's rate.

Interest rates for an insurance policy loan typically fall between 7 and 8 percent, which is somewhat higher than the rates on many student loans, Mott said.

"While the loan itself doesn't have to be paid back, the outstanding value will be deducted from the death benefit when the insured dies; the interest needs to be paid in a timely fashion," she said. "If not, the accumulated interest is added to the loan value which increases both the loan balance and the amount of future interest owed."

The risk with non-repayment of interest is that the loan balance grows beyond the value of the death benefit and the policy lapses," she said.

Mott recommends before you make a decision, there is no harm in shopping around to be sure this is the best value available to you. Many employers offer insurance for children as a benefit to their employees which might be a more cost-effective solution, she said.

Jody D'Agostini, a certified financial planner with AXA Advisors/The Falcon Financial Group in Morristown, said there are probably better places to spend your money on your children than buying a life insurance policy on them.

She said financial planning is based on your goals and your entire financial picture. Life insurance is inexpensive for children, because they are not expected to die at an early age.

"I think other goals such as future college tuition, a family emergency fund that could be tapped with a premature death, or your retirement could take precedence," she said. "You should first be sure that as parents, you have sufficient life insurance on yourselves to cover debts and loss of income, as well as final expenses."

She said if you purchase life insurance on yourself or your spouse, you might be able to include additional coverage on family members for a small additional premium.

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