

MEC

Understanding the Modified Endowment Contract Essential Information for People with Life Insurance or Considering It

If you have life insurance, or are in the process of purchasing it, you should understand what the term “Modified Endowment Contract”—aka MEC—means.

MEC policies offer advantages and disadvantages. You may choose to buy a MEC, or not. Or, you may learn that your non-MEC policy has been reclassified as a MEC because of an action you took. The good news is, this is something you can control.

MEC vs. Non-MEC Policies

“MEC” and “non-MEC” are policy classifications based on IRS rules. Both types of policies provide a death benefit and accessible, increasing cash values. With both, death benefit proceeds are not subject to taxation. However, they accumulate cash value at different rates—due to when and how much premiums are paid—and cash distributions (including loans) are taxed differently.*

One of the advantages traditional non-MEC policies offer is accessible cash value through a policy loan with no tax consequences throughout the life of the policy. While MECs also offer accessible cash value, there can be tax consequences for distributions taken when there is growth in the policy.

So, why would anyone choose a life insurance policy that creates greater potential tax liability? Because even after taxes and potential penalties, MECs may offer a higher net cash value than non-MEC policies, due to the fact that they can be designed with a greater focus on cash value.

	Non-MEC Policies	MEC Policies
Taxation of Death Benefit	Transfers tax-free	Transfers tax-free
Tax-deferred Cash Value Growth	Lower than MECs typically	Higher than non-MECs typically
Order of Withdrawals of Cash Value	Basis (contribution) is released first	Gains (interest and dividends) are released first
Tax Implications of Withdrawals	Basis is tax-free	Gains are taxable as ordinary income
Penalties for Withdrawals	None	If under age 59½, an additional 10% on gain

When It Makes Sense to Purchase a MEC

Deliberately purchasing a MEC may be a smart move in situations where you want to ensure superior tax-deferred cash value growth over time. However, it is ultimately *your decision* if a MEC is appropriate for you.

People often choose MECs when:



Planning for College

The cash value in life insurance policies isn't factored in when completing a financial aid (FAFSA) form, so monies in a MEC may improve a student's aid eligibility while simultaneously saving for college.



Saving for a Large, Long-term Purchase

Such as funding a second home or a year of travel, say, 10 years down the road.



Wealth Transfer

Increasing a wealth transfer by purchasing a tax-free death benefit, greater than lump sum paid, with monies otherwise marked as "rainy day funds".



Estate Planning

Investing a lump sum of available monies into a MEC (versus a non-MEC) may yield a larger death benefit years later.



To Make Money Work Harder

Because MECs provide both a death benefit and fast-growing, accessible cash value.

How Traditional Non-MEC Policies Become MECs

A premium payment you make or benefit reduction you request can unintentionally cause an existing life insurance policy to enter MEC status. Here's why:

- According to IRS code section 7702A, a MEC is a life insurance policy that is deemed investment-oriented rather than life insurance-oriented due to the amount of premiums or how quickly premiums are paid. There is a relationship between the policy cash value and death benefit that must be maintained.
- If the policy becomes too "cash rich" too quickly—as determined by an IRS formula called the "MEC test"—a non-MEC policy could become a MEC.

If this should happen with your Mutual Trust policy, we will notify you by mail. You'll be given the opportunity to request a refund of the excess premium payment that triggered the reclassification. Or you may elect to leave the policy as a MEC. Whatever you decide, we will work with you to ensure that your policy's MEC status is in your control.

Still have questions? Contact your Mutual Trust Representative today!

** Neither Mutual Trust Life Solutions, nor independent agents or affiliates, offer tax or legal advice. For tax and legal issues, including those related to MECs, please consult a tax or legal expert of your choice.*

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