IMPACT OF THE 2016 ELECTION ON THE LIFE INSURANCE BUSINESS & U.S. ECONOMY

The national election on November 8 produced one of the biggest upsets in presidential history as Donald Trump defeated Hillary Clinton.

Pundits and financial planners, prepared to begin discussing Mrs. Clinton's economic agenda on November 9, instead now find themselves confronting a very different conversation. Below is a brief and general overview of what the election results may mean for the life insurance industry and estate and financial planners. Only time will provide clarity.

Donald Trump's Tax Proposals

Although we will not know the exact details of any tax proposal until after inauguration, in speeches on August 8, September 13, and September 15, 2016, then-candidate Donald Trump described his new framework for a revised tax plan.

In summary, the plan would significantly reduce marginal tax rates, increase standard deduction amounts, repeal personal exemptions, repeal the 3.8% Medicare surtax, cap itemized deductions, and allow businesses to elect to expense new investment and not deduct interest expense. His proposal would cut taxes at all income levels, although the largest benefits, in dollar and percentage terms, would go to the highest-income households. Mr. Trump has also stated that he would repeal the federal estate tax.

The following are some of our observations and analysis of selected parts of the proposals, including their potential impact on the life insurance industry.

The Individual Income Tax

Under Trump's plan, individual income tax rates would be reduced from seven brackets to three: 12, 25, and 33 percent (plus zero per cent for earnings below the first bracket). In addition, the brackets themselves phase in at slightly higher income levels. For example, no tax is imposed on the first $30,000 of income for a married couple filing jointly. Compare this with $20,700 under current law. Also, the head of household filing status would be eliminated.

The elimination of the current top brackets, 39.6% and 35%, may make deferral of ordinary wage income less attractive for higher-compensated individuals from a tax perspective. And changes to income deferral, broadly, could affect inflows to qualified defined contribution plans. Additionally, the market for non-qualified deferred compensation arrangements could be pressured. Since such arrangements often involve the use of cash value life insurance for its several tax benefits, the market for cash value life insurance in this space could contract from where it is today.

Similarly, the use of cash value life insurance to provide supplemental income in retirement may appear less attractive. Because cash value buildup in a life contract is tax-deferred, and because of the Section 72(e) treatment of redemptions from a life contract on a first-in/first-out basis, personally owned life insurance has been an attractive vehicle for those who already contribute the maximum to their qualified defined contribution plans. However, since the decision whether or not to purchase life insurance always requires taking the long view, consider that significant cuts in the personal income tax has often been followed later by increases, potentially in effect at retirement. Moreover, even though the tax motivation for purchasing life insurance may be impacted by the ultimate tax proposals, we maintain that the purchase of tax-advantaged financial vehicles such as life insurance – even during a time of low taxes – continues to be a smart move for many clients and should be closely aligned with solving the needs of the consumer in their overall financial plan.

Estate and Gift Tax

Under Trump's plan, federal estate, gift and generation-skipping transfer taxes would be eliminated. However, based upon some of his statements during the campaign, the step up in basis for assets transferred to heirs at death may also be eliminated. That is, transfers of appreciated assets would retain the owner's original basis rather than be stepped up to the fair market value of the assets at date of death. This would result in potentially higher taxable gains to heirs.

It is early. And we do not know whether estate tax repeal and/or changes to the step up in basis will be a part of the final proposal in the House and Senate. That being said, the elimination of transfer taxes would completely transform wealth transfer planning. As a consequence, the role life insurance currently plays in the high net worth planning market may be impacted in several important ways, including diminishing or changing the overall need for life insurance for estate liquidity, depending upon what taxes may or may not be levied at death.

To whatever extent life insurance retains its relevance in the estate tax planning space, the focus of clients may turn away from products offering iron-clad guarantees in exchange for low (or no) accumulation potential, and more toward products with strong cash value accumulation potential, in order to build in a cost-recovery contingency should laws change again. And the ability to offer a "best of both worlds" solution may become the topmost priority for product providers.

Tax on Corporations

Apart from generalized benefits flowing from Trump's proposed reduction in the top corporate income tax from 35% to 15%, the proposed repeal of the corporate alternative minimum tax (AMT) could benefit the life insurance industry.

This is because under current law, life insurance death benefits payable to a corporation are a non-preference item under the AMT. This means that death benefits can have the double disadvantage of pushing corporations toward the AMT income threshold, and also being taxed themselves under the AMT, losing their chief advantage to the corporate owner.

Without the corporate AMT, life insurance death benefits would not be taxed. This end result may cause the other attractive features of life insurance to become even more attractive – namely its tax-advantaged investment accumulation, which can be used as an efficient source of capital through first-out redemptions and favorable contract loan terms. Moreover, regardless of its corporate tax benefits, the use of permanent life insurance in facilitating business transfers will continue to be critical.

Estate Tax Repeal

Outright repeal of the estate tax may be complicated due to complex budgeting and appropriations rules. For historical comparison, President George W. Bush was able to push through estate tax repeal as part of the 2001 budget bill which also reduced top income and capital gains tax rates, and taxed dividends as long-term capital gain. But the repeal of the estate tax had to be postponed so tax relief could be granted elsewhere (largely, income tax reductions), and it was ultimately abandoned after the law "sunset" in 2010. Consequently, many estate tax planners never really experienced the significant reduction in business, although there is no doubt that the overhang of repeal can have a chilling effect on estate planning. We will watch developments closely after inauguration to see what the final contours of any potential tax reform are.

Gift Tax Repeal

A potential policy objection that may emanate even from Republican ranks involves the gaping revenue hole left by full repeal of the gift tax. Without it, it is not possible to have a truly rational tax system, however liberal it may be otherwise.

The gift tax protects the system from the effects of a leaky income tax. If the gift tax were repealed a taxpayer could shift income without tax cost to another who is in a lower tax bracket. A parent could simply gift an asset to be sold to a child to sell. Absent a gift tax "wall" there might be no impediment to making such a transfer. The child could then sell the asset, recognize a lower income tax than the parent, and then gift some portion or all of the proceeds back to the parent. The gift tax may well survive, potentially increasing the tax base subject to capital gains treatment at death, where life insurance has a direct and practical application.

Congress and the Executive

In addition to Trump's personal victory, the Republicans were also victorious. The House of Representatives is controlled 235 to 191 by the Republicans, and the Senate is controlled approximately 51 to 47 by the Republicans, with two seats pending runoffs as of this writing. The Republican majorities will make it more likely that many of Trump's tax proposals could be enacted.

Nevertheless, Republicans are not assured to line up as a block behind Trump's proposals. After a bruising presidential campaign during which Mr. Trump seemed to feud almost as much with some leading Congressional Republicans as with his opponent, he may have to spend time building bridges. This will almost inevitably involve some compromise on positions.

Summary

Remember that clarity in direction does not equal certainty in outcome. The lessons of George W. Bush, and Ronald Reagan before him, are that even the boldest fiscal plans are subject to dilution and compromise, and even complete rollback of some of their provisions. The key for planners is to maintain flexibility for their clients. And cash value life insurance, especially, can help maintain that flexibility by offering clients both a death benefit they need and a cost-recovery exit if it becomes unnecessary.

Regardless of the outcome of these tax proposals, the core needs that life insurance addresses, separate from its tax advantages, have always been what truly drive people to purchase it; namely, immediate and timely cash when a family or business needs it most-- during lifetime or afterwards. The fact remains, there is no other financial vehicle that can provide flexibility and versatility a family requires over lifetime than permanent life insurance, regardless of tax law.

Please see the Advanced Marketing library of tools on planning for core non-tax liquidity needs including, Basic Estate Planning Solutions, Business Succession Planning, Strategies for Retaining Key Employees, Estate Equalization Planning, Maximizing Social Security with Life Insurance, Life Insurance in Retirement Planning, and Planning for Special Needs Individuals and Non-citizen Spouses.

Questions? Call Advanced Marketing at 1-800-800-2738, Option 4


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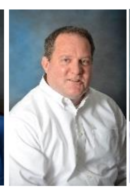
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