Insurance Assets May Surge With a New Wealth Tax

A tax idea to disperse wealth, that is unfavorable for investors, is gaining national attention at rapid pace.

Traditionally, taxes on capital gains are taken when gains are realized. This may change with proposals from some current and potential future lawmakers. There is strong appeal for many to tax capital gains in new ways to spread wealth by taxing owners with heavy interests in tradeable assets such as stocks, bonds and commodities.

One new proposal is to replace the “pay when you want” strategy with a “pay as you go” system. The proposal would oblige asset owners to pay yearly capital gains tax on owned instruments that are tradeable assets. The definition of tradeable is clear for many assets such as shares of MSFT or SPY ETF, but for other investment instruments it is less obvious.

The main proposal behind this method is to pay the capital gains tax as the assets remain long, regardless if the sale is booked. The unrealized capital gains tax could be as low as capital gains tax rates today, or in some proposals as high as ordinary income tax rates. Not only is the tax rate important, but the frequency of payments becomes a significant factor. Would you pay the IRS quarterly like income tax bills, or calendar payments when you file?

Financial professionals will have to prioritize cash management modeling within portfolios to be able to pay tax bills.

The tax and payment of, may force assets to be sold in undesirable market conditions simply to meet the tax obligation. This may cause additional periodic volatility for equity and other markets that we shall save for later output.

There are other proposals being discussed and drafted that would include back taxing non-tradeable assets.

A tax may be collected at the time of the realized event to include a look-back charge as if the tax were collected each year if mark-to-market pricing were available on that asset.

Time discovers all truths, and November is right around the corner. Regardless of proposal and law, one asset class is sure to earn new attention with investors.

INSURANCE.

Many planners look to insurance to protect the core. This will always remain one key insurance planning element. However, the tax benefits of insurance will attract financial professionals and wealthy investors far beyond estate tax and legacy planning.

Life insurance and annuities offer tax deferral during accumulation years. This tax deferral is attractive and competes with many qualified plans without the requirement for the asset to be owned in such account types.

It is highly unlikely insurance will lose its tax-favored status within any of the current or future unrealized capital gains tax plans. This makes insurance attractive for wealthy investors looking to new asset classes that still offer heavy tax advantages.

In most instances' insurance is illiquid in the short-term due to low growth values, fees and other charges involved in the early years of insurance products. Most plans call for the asset to be held to a specific event such as the maturity of the product or planning event triggering the usage. Some will argue this is the same as a bond or stock portfolio. Regardless, the laws protecting, and governing insurance are likely to remain in force due to its traditional management.

The many hedge benefits of insurance should become more attractive as taxation of all types increases in rate and potential frequency such as unrealized capital gains tax. In life insurance the owner benefits from tax deferral, may distribute the asset tax-free if properly funded, and may pass the asset on income tax-free at death.

Both life insurance and annuities offer classes of products that give the owner the ability to participate in market correlated growth while accumulating tax deferred. At the same time, many insurance instruments offer a “put” that keeps the product’s floor at 0% rate of return or more.

Insurance returns may also serve planners as a benchmark for other return/risk strategies involved in portfolio management.

Insurance products have been used for decades by wealthy families and their planners for deferral, debts, distribution and death. Changes to the future tax code may now prove an additional advantage against the impacts of unrealized capital gains to liquid and non-liquid investment holdings.

Timing will be essential. With interest rates at historic lows, volatility and its pricing effects, and other competitive factors, insurance manufacturers may scale back on product development and the attractive terms of existing contracts. Should our government revoke benefits afforded to insurance or alter taxation in the future, ownership of these assets and the date they were purchased could play a key role in any grandfathering the government may warrant. These two points make the time to allocate to insurance more urgent than before.

Change is inevitable and taxes and financials are never immune. The present may be an ideal time to consider alternatives to common portfolio interests such as insurance offerings.

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