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How Are We Going to Pay for it All?

As we watch the US Congress pass out large sums of stimulus money for infrastructure, alternative energy, myriad green initiatives, cash for clunkers, the question lurking behind all the spending initiatives – including the current debate on health care reform — still comes down to this — "how are we going to pay for it all?" In some form, taxes will surely go up.

Some revenue raising suggestions to "pay for it all" have included taxing health insurance benefits provided by employers (add to W-2 income) and then allow an individual taxpayer deduction up to some reasonable limit in its place, tax health insurance companies for offering "Cadillac plans", increase federal income taxes for individual taxpayers who make over $250,000 or some similar number in annual gross income, tax the sales of life insurance and the age-old recurring suggestion to tax the inside buildup of cash value on life contracts.

One result of the current hectic search for additional tax revenue is that project planning decisions at many organizations become frozen, waiting for some clarity to emerge so that planning for future consumer products and projects can forward. Even in this state of flux, there are two statements on which we can all agree – (1) taxes will be higher on many assets or transactional events that we already tax and (2) there will be more assets and transactional events that become taxed.

Given this scenario, proactive planning should begin now on how your organization will support the challenges that will be laid out before all of us. In the areas of regulations and taxation – old, new and revised – we can recognize that there are fundamental patterns that consistently underscore all the final details. Taxes, and the regulations in which taxation concepts exist, work hand in hand, so they must be considered together when looking for support patterns. The underlying tax/regulatory patterns within the insurance/annuity/health arena are:

- Gatekeeper Functions
- Counting and Calculation Functions
- Reporting Functions

Organizing your processes and software support design within these generic three patterns will allow pre-planning and flexibility when the time is right to support yet another new regulation or tax rule.

Gatekeeper Functions

Examples of well-known gatekeeper functions include checking that a deposit into a life insurance contract will not violate the definition of insurance, checking to ensure that a loan is not taken out on an IRA annuity contract (a prohibited transaction), checking to determine if a contract will become modified endowment contract status when a payment is made that violates 7-pay premium and checking to ensure that only the owner is allowed to accomplish a loan request on a life contract. These gatekeeper functions are used to either prohibit an activity from occurring or to provide an alert for exception processing.

Counting and Calculation Functions

Current examples for common counting/calculation functions include counting amounts into and out of a contract's cost basis, calculating guideline annual and single premium amounts, calculating 7-pay premium amounts, calculating earnings/gain when a distribution is made from a life or annuity contract and calculating of federal and state withholding, if required, from any distribution.

Reporting Functions

Reporting functions include the production of 1099R forms to taxpayer and to the US Treasury to document taxable events from distributions, production of 1099R forms for the reporting of 1035 exchanges, and production of 5498 forms for Individual Retirement Accounts (IRAs) to reflect contributions, conversions, accumulated balance amounts and on traditional IRAs if an owner is over age 70 and ½ and subject to minimum required distributions.

All regulations and taxation structures exist today within the three basic frameworks above. In designing a software support solution for whatever new regulations and taxations emerge from Capitol Hill (or state or local level for that matter), a generic framework will enable your organization to adapt to the new rules and tax laws with ease. These will include:

- Edits/checks occurring to detect certain kinds of events for alert purposes or prohibition purposes
- Counting and calculation functions that are triggered by either external or internal events (e.g. a payment deposit made, a claim event coming in, a request for a withdrawal of funds, an anniversary process occurs and interest on a loan is capitalized, etc.)
- Reporting that will occur periodically to one or more parties – taxpayer, US Treasury, a new department in Washington DC, etc. Reporting will include not only taxable amounts but reportable only event details.

We cannot predict the final forms of new taxation. *But for purpose of discussion only, assume one or more of the following materialize from details of stimulus initiatives and health care reform:*

Health care reform requires an X% premium tax on all life insurance of face amounts over $1,000,000

Benefit payouts in health plans for 'Cadillac Services' which provide private hospital room care, require a .5% tax paid on the outbound benefit amount, payable by the insurer

Life insurance death proceeds over $1 million face amount trigger an excise tax separate from the current estate tax to subsidize both stimulus initiatives and health care reform.

None of the above scenarios is required to support today — but they could be. If you plan your company's regulatory and taxation software solutions with underlying general patterns in mind, you will be able to easily take on challenges the new laws will bring with them.

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