A Financial Services Transactions Tax Is Looming – Are You Ready?

Given the severity of the Federal deficit, and the current near-exemption from tax of most financial instrument trade transactions, it is inevitable that some form of financial services transaction tax will be implemented at the Federal level in the future. While current rhetoric is directed largely towards Wall Street brokerage accounts trades — stocks, bonds, mutual funds — insurance companies should not assume they will be exempt from the tax. Taking a broad view, many insurance company money transactions involving life insurance and annuity contracts look very similar to Wall Street investment instruments.

This article is not intended to address any of the arguments for or against such a tax. The purpose is to cause you to consider how your company may be impacted when the time comes that you may need to comply.

Isn't it best to have your proactive analysis underway for when the time comes?

A financial transaction tax sounds simple at first consideration. How difficult can it be to multiply a few miniscule basis points times a financial money movement? It seems obvious what 'money movement' looks like. For example, if the financial services tax is .01%, then a purchase of $100,000 of stock would yield $10 of tax. The tax must be sourced from somewhere and accounting performed to accompany it. But as usual, the 'devil is in the details'. For insurers, critical questions to be asked and resolved could include the following:

• Could the new transaction tax apply to all instruments or only those contracts that have some form of cash value which look like investments? Would term insurance or health insurance premiums be 100% exempt? If not exempt, could different tax rates apply?

• If a tax is applied against a given contract type, will the tax be calculated against the gross deposit/premium? Or will it be levied against a lower net figure that already has state premium taxes extracted to avoid causing a 'tax on a tax'?

• How will transactions such as non-qualified contract 1035 exchanges and qualified contract trustee-to-trustee transfers to be impacted? These unique transactions are used to accomplish practical transfer of money among contracts in a form of 'seamless exchange'. Exchange events are not taxable today for income tax, so should they be exempt from the tax?

• How will overpayments or premium refunds to be handled under the new tax? For example, if a check for $1,000 is sent in to the insurer and is applied against a contract and only $700 is due, is the tax calculated against the $1,000 at the time of the deposit itself or is it against the $700 only and then later calculated against the $300 residual when it is properly applied in the future? In summary, how should unidentified or 'early money' that cannot yet be booked as income be treated if held in an unresolved suspense account?

• If an in-force variable annuity contract or variable universal life contract has an asset rebalancing feature, will automatic money movements among the various funds under the same contract constitute a transaction that must be taxed? In other words, are movements of money within a single contract considered to be taxable events?

• When a deferred annuity contract owner invokes an annuitization option, where the lump sum value of the fund accounts are used to 'fund' the annuity payout stream, would this be considered a taxable financial transaction?

• If a contract owner initiates a loan against his/her own life or annuity contract, is this a taxable financial transaction? How about loan repayments – will these be taxed? Does this not mean the owner is being taxed to access his/her own money?

• Accelerated death benefits which advance death claim proceeds to a living party – are these considered to be taxable? Life insurance death claim proceeds are not generally subject to income taxes, so are these 'early death claim payments' going to be subject to the new tax?

Given the Federal government's desperate need to find sources of new tax revenue, expect that some form of taxation is on the horizon. You should be planning now for the potential impacts on current administration processes and your software support to enable compliance.

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