ACLI Submission Letter to Individual Income Tax Working Group

In efforts to reform the tax Code, Congress should look to the life insurance industry as a partner that encourages families to plan for the long term and protect their financial and retirement security. The products that our policyholders use to build a personal safety net, including those provided through the workplace, are vital to a well-functioning society and, for millions of families, build on the floor of financial security that government programs provide. The protections and guarantees our products offer are not available from any other financial services companies.

The life insurance industry already bears a significant tax burden under current law and is impacted in a multi-dimensional way in tax reform.

- Life insurance and retirement savings products are taxed appropriately under current law. The savings that build up in life insurance, annuities and other retirement savings products do not escape taxation. They are taxed at ordinary income tax rates when people make withdrawals from their retirement savings or annuity, or cash in their life insurance policies if protection is no longer needed. Additionally, life insurance and annuity owners pay premiums with after-tax dollars.
- Life insurers account for 1.7 percent of corporate profits, but pay 2.5 percent of corporate sector tax revenue.
- Tax reform has a layered impact on life insurers because general corporate, insurance-specific, investment, and international tax provisions apply to our companies, and individual provisions relate to our products and retirement savings. These interrelationships and their cumulative effects must be acknowledged as tax reform is considered.

The nature of insurance company product design means that given the long-term contractual and pricing constraints of current contracts, the burden of changes to the tax Code falls disproportionately on future policyholders and customers, including business owners providing employee benefits and protections through products. Changes to the tax treatment of either products or life insurance companies would affect the availability and affordability of our products at the very point in time that private sector protections and guarantees are needed most to backstop strained public safety nets.

Attached are additional materials specific to the Working Group on Individual Income Tax. We ask that you consider these overarching themes here as you address any reforms related to our industry.

April 15, 2015

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Annuities: Creating Guaranteed Income for Life

Retirement today requires more planning than in previous generations. Sources of steady retirement income have changed, as fewer and fewer workers are covered by traditional pensions that provide a lifetime benefit. In addition, advances in medicine have resulted in increased longevity and today's retirees may spend 20, 30 or more years in retirement.

Given this landscape, workers face two dilemmas: how to accumulate savings for retirement and how to generate a stream of income in retirement guaranteed to last a lifetime. A 2014 survey shows that only 18 percent of American workers are very confident that they will have enough money to live comfortably throughout their retirement years, down from 27 percent in 2007.[1]

With the increased popularity of defined contribution plans, such as 401(k)s, responsibility for making sure retirement savings last has shifted from the employer to the individual. Unlike traditional defined benefit plans that provide a stream of payments to retirees for life, defined contribution plans typically offer a lump sum that retirees must then manage on their own.

The only way to create a guaranteed lifetime income stream in retirement is through an annuity. An annuity is an insurance contract that offers an efficient solution to what otherwise could be an overwhelming asset management task: Creating a steady paycheck in retirement that cannot be outlived.

SUCCESS OF THE PRODUCT

Annuities are insurance contracts that offer solutions to both sides of the retirement equation: They provide ways to accumulate retirement savings and to turn those savings into a lifetime income stream.

The recent economic crisis has highlighted and enhanced the long-term value and guarantees that annuities provide. In fact, despite the market turmoil, 85 percent of current annuity owners say that annuities were a safe and secure way to save for retirement and that annuities make them feel secure in times of financial uncertainty.[2]

A deferred annuity can address both pre-retirement savings and post-retirement income needs. For example, for those who are years away from retirement—or are retired and don't need to produce income right away—a deferred annuity allows savings to accumulate, tax deferred, until you choose to receive income payments. Annuity owners decide how their money accumulates—at a fixed interest rate, an indexed interest rate, or a variable interest rate. They also choose how and when they receive income—in a lump sum, as payments over a specified number of years, or through a steady stream of income they can't outlive.

For those who need income right away, an immediate annuity converts a lump sum of money (such as money from the sale of a home or business, or a portion of accumulated savings in a workplace retirement plan) into a series of monthly, quarterly, or annual payments. The annuity owner chooses if those income payments last for a specified number of years or for life.

AALU
Leadership for Advanced Life Underwriting

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Financial Security...for Life.
AMERICAN COUNCIL OF LIFE INSURERS

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NAFA®
National Association for Fixed Annuities
Securing the Future!

NAIFA®
SECURING AMERICA'S FINANCIAL FUTURE

NAILBA
The Voice of Independent Brokerage Distribution

[1] Employee Benefit Research Institute, *2014 Retirement Confidence Survey*.

[2] Committee of Annuity Insurers, *2013 Survey of Owners of Indivdual Annuity Contracts*. (Conducted by The Gallup Organization and Mathew Greenwald & Associates.)

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Certain annuities offer the option of continuing income payments to a spouse (or other beneficiary) after the annuity owner dies. Some also provide death benefits if death occurs before income payments begin. Other options also may be available, such as guaranteed living benefits, which provide additional savings and income protection.

CURRENT TAX TREATMENT

By encouraging long-term savings during the working years and helping individuals manage assets during retirement, the current tax treatment of annuities promotes financial discipline.

For those who are years away from retirement, or are retired and have assets that don't need to produce income right away, a deferred annuity allows savings to build up, free of current federal income tax. When payments are received, the portion that comes from earnings is taxed as ordinary income.

To encourage long-term savings for retirement, there are tax penalties for withdrawals from deferred annuities before age 59½ in addition to the income tax due on earnings. The tax penalty is not applied to certain lifetime payouts, death benefits, or payments made if an annuitant becomes disabled. Other exceptions may apply.

The current tax treatment has served as an effective savings incentive: 73 percent of individual annuity owners report that they have set aside more for retirement than they would have if the tax-deferred growth of annuities was not available. A large majority (86%) cite the tax treatment of annuities as a "very" or "somewhat" important reason for their purchase.[3]

The current federal income tax treatment of annuities is reflective of sound public policy that recognizes the annuity's unique role in helping Americans accumulate savings for retirement and guarantee a steady stream of income for life.

CONCLUSION

An annuity can help American workers meet the challenges of the changing retirement landscape. In fact, 85 percent of individual annuity owners say they believe that annuities are an important source of retirement security and make them feel more comfortable in times of financial uncertainty.[4] With the shift from defined benefit to defined contribution plans and increased longevity, the role of the annuity in retirement has never been more important. Policy-makers should explore ways to encourage more Americans to turn to annuities for long-term savings and guaranteed lifetime income.

KEY FACTS

- More than three in four (84%) annuity owners say that they will use their annuities for retirement income.[5]
- Over seven in 10 (72%) annuity owners are 64 years old or older, including nearly half who are age 72 or older (46%).[6]
- Individual annuity owners received $51 billion in benefit payments in 2013.[7]

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3 Committee of Annuity Insurers. *2013 Survey of Owners of Individual Annuity Contracts.* (Conducted by The Gallup Organization and Mathew Greenwald & Associates.)
4 Ibid.
5 Ibid.
6 Ibid.
7 American Council of Life Insurers, *Life Insurers Fact Book 2014.*

Life Insurance: Providing Financial Protection

Life insurance is a key component of Americans' ability to take individual responsibility for the financial futures of their families and businesses. It is unique in guaranteeing the delivery of financial security at precisely the moment it is needed, while contributing significantly to the nation's storehouse of savings and investment capital.

A big fear for many American families is the death of a wage-earner or caregiver, leaving the surviving family members unable to cope financially. Life insurance offers peace of mind through immediate financial protection for dependents.

Life insurance enables individuals and families from all economic brackets to maintain independence in the face of financial catastrophe. In a recent study, more than three in four respondents strongly agree that life insurance is a critical part of a financial plan.[1]

By providing tools for protection and savings, life insurance is an efficient way to promote personal responsibility and thus relieve pressure on government programs. There continues to be strong public support for continuation of current tax policy for life insurance products.

SUCCESS OF THE PRODUCT

Life insurance protects families against financial loss from the death of a loved one. It provides a source of reliable liquid assets when the need arises to pay for death-related expenses, including medical bills and funeral costs. It also can help families cover daily living expenses, mortgage and tuition payments, and child care.

The amount of life insurance is determined by the financial needs of individuals and families. Some experts suggest coverage should equal at least seven to 10 times annual income. It is impossible for most families to save enough money to manage the financial consequences associated with the death of a wage-earner or caregiver. Life insurance makes managing these risks affordable through the pooling of risk. Industry data shows that in 2013 there were 144 million individual life insurance policies in force.[2]

Permanent life insurance has an additional advantage—it is guaranteed to remain in force for one's whole life, regardless of age. By design, the level premiums of permanent insurance are used to both pay for the term cost of a policy's face amount (death benefit) and to create a savings aspect (cash value), which helps cover the rising cost of insurance as one gets older. In addition, the policy's cash value can be borrowed to pay important family expenses, such as those for tuition or long-term care. If an insured's needs change and the death benefit protection becomes less acute, the cash value can be converted into a retirement income producing annuity that can guarantee regular payments for life or for a specified period of time, an option also available to beneficiaries of life insurance policies. Some policies allow an insured to collect all or part of the death benefit if he or she becomes terminally or chronically ill. An insured also can cancel (surrender) the policy and receive the cash value as a lump sum. Fifty-seven percent of respondents in a 2009 survey said that one of the most important benefits of life insurance is its cash value because it is a built-in reserve for emergencies.[3]

[1] American Council of Life Insurers, *Monitoring Attitudes of the Public 2009.*
[2] American Council of Life Insurers, *Life Insurers Fact Book 2014.*
[3] American Council of Life Insurers, *Monitoring Attitudes of the Public 2009.*

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Businesses use permanent life insurance to protect against financial uncertainty and secure their employees' futures. By owning life insurance on key employees, businesses have a secure funding source to pay for important employee and retiree benefits and to protect jobs and families from financial loss and instability that can result from the death of an owner or key employee.

CURRENT TAX TREATMENT

Policy-makers have long-recognized the important social policy served by encouraging individuals and families to protect themselves against financial risks, rather than depend on government to do so. Since its inception in 1913, the tax code has provided that death benefits—and the cash value in permanent life insurance—are not subject to income tax.

Premiums are paid with after tax dollars—there is no deduction for premiums paid. Earnings on a permanent life insurance policy's cash value are not taxed as long as the policy remains in force. However, if a policyholder gives up his or her insurance protection, earnings in excess of the total premiums paid are subject to tax.

There are strict limits on the savings aspect of life insurance to ensure its tax treatment is not abused. Contracts that do not comply with these limits are denied the tax treatment entitled to life insurance.

The protection afforded by life insurance is an important societal benefit that public policy has consistently validated. This policy has been reviewed several times over the last century, and each time Congress has chosen to preserve the current tax treatment of permanent life insurance.

CONCLUSION

The current tax treatment of permanent life insurance encourages individuals, families, and businesses to efficiently manage risk and prepare for long-term financial needs, despite a general environment that focuses more on the short-term. Americans are facing greater hurdles than ever before when planning for financial security. Any changes to public policy must encourage Americans to plan for their financial futures.

KEY FACTS

- 75 million American families count on life insurers to protect their financial futures.[4]
- American families have more than $19.66 trillion worth of life insurance protection through individual policies and group certificates.[5]
- In 2013, life insurance beneficiaries received $64 billion in death benefits.[6]
- At the end of 2013, 144 million individual life insurance policies were in force.[7]
- Of new individual life policies issued in 2013, 64 percent were permanent life insurance policies.[8]
- 78 percent of respondents to a recent survey believe that it is important for the government to encourage people to protect their families with life insurance.[9]

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4 ACLI calculations based on U.S. Census, *Current Population Survey 2013*, and Federal Reserve Board, *2013 Survey of Consumer Finances*.

5 American Council of Life Insurers, *Life Insurers Fact Book 2014*.

6 Ibid.

7 Ibid.

8 Ibid.

9 American Council of Life Insurers, *Monitoring Attitudes of the Public 2009*.

Tax Policy Supports Risk Transfer

	Risk Transferred	Tax Treatment at Purchase	Tax Treatment at Accumulation Stage	Tax Treatment at Payout Stage
Individual Life Insurance	Mortality risk (Ensures dependents can be financially secure)	Premiums are paid with after-tax dollars; premiums are not deductible.	Earnings on build-up of savings (cash value) of permanent life insurance are not taxed as long as the policy remains in force.	Death benefits are not taxed. If a policy is surrendered or lapses before death, earnings in excess of the total premiums paid are taxed at ordinary income tax rates.
Annuities	Longevity risk (Ensures retirement income will last as long as annuitant—and spouse—live)	Non-qualified (individual) annuities are purchased with after-tax dollars. Qualified annuities, which are funded with money rolled over from a qualified defined contribution plan, are purchased with pre-tax dollars.	Any earnings grow free of current federal income tax.	When income is received from an individual annuity, the portion that comes from earnings is taxed as ordinary income (the principal is not because it has already been taxed). Tax penalties exist for withdrawals before age 59 ½. Payouts from qualified annuities are subject to ordinary income tax. Qualified annuities are also subject to "required minimum distribution" rules: withdrawals must begin by 70 ½ or tax penalties apply in addition to income tax due.
Long-Term Care Insurance	Financial risk (Ensures savings are not depleted to pay for long-term care services to assist with the activities of daily living)	Premiums are paid with after-tax dollars. A portion of long-term care insurance premiums may be deducted as part of medical expenses if amounts exceed 10% of adjusted gross income.	Not applicable	Benefits are not taxed except for per diem policies that pay amounts that exceed $330 as set by the IRS.
Disability Income Insurance	Loss of income (Ensures continued income in the event of disability)	Coverage purchased with after-tax dollars by individuals cannot be deducted; employers can deduct premiums if they pay for employees' coverage.	Not applicable	With an individual policy, benefits are not taxed if the policy holder pays the premium in full; benefits are taxed at ordinary income tax rates if an employer pays for coverage.