

The life insurance premium tax is a relic from the past that hurts insurers in their intense competition for savings dollars.

Outdated Premium Tax Must Go

The premium tax is a competitive disadvantage for cash-value policies. No other industry imposes such taxes upon investments. Given the consolidation of the financial-services industries, the premium tax needs to be eliminated. It is a relic from an era when the life industry routinely denied a cash-value policy's intrinsic investment nature and rejected the necessity of establishing its competitiveness against investments. While this tax remains obscured in traditional products, variable products' prospectuses highlight all too well this industry-specific disadvantage. Today's intense competition for savings dollars requires that the life industry make products as attractive as possible. Consequently, no longer should the investment component of cash-value premiums be so unnecessarily burdened.

Almost all states have eliminated the premium tax on annuities and on life insurance premiums in qualified plans. Apparently, these products' investment aura has freed them from the premium-tax shakedown. But anyone who really understands cash-value life insurance, who understands "financial chemistry"—that is, the distillation of a product into its fundamental components—knows that cash value is simply term insurance with a tax-privileged side fund. Neither history nor tradition nor any other reason justifies continued acceptance of this masochistic tax on cash-value policies when its imposition on the industry's other investment products has been recognized as folly.

Many have suggested that the consolidation of financial services calls for the homogenization or rationalization of the formerly separate industries' tax rules. A seemingly superior solution, originally proposed by others, is to subject life insurers to ordinary corporate income taxes. Given recent changes in certain life insurance accounting practices—which separate premiums into two components, income and deposits—an income tax (without a premium tax) is a logical, complementary next step. In this case, investment dollars (deposits) would grow tax free under the umbrellas of the investment company act and cash-value policies' tax privileges. Alternatively, insurers' taxes could be based upon amount-at-risk or face amount. Any of these alternatives would enhance the competitiveness of cash-value policies vis-à-vis other savings products, as well as term insurance.

This argument against the premium tax is not an argument for lower industry taxes. Obviously, though, if the industry's tax burden/payments remain the same and cash-value policyholders pay less than they currently do, then term policyholders would have to pay more.

While some might object to this proposal, they should first consider why one who buys a \$300,000 cash-value policy should pay more in taxes than one who buys a \$300,000 term policy. After all, as buyers' guides explain, cash-value policy costs are not equal to premiums (so the sales tax analogy does not hold); furthermore, a cash-value policy's tax privileges are bestowed, not bought. Consequently, since there is no inherent, compelling reason to have cash-value policyholders pay more taxes, it would seem that it ought to be up to the industry and the regulators to determine how the industry's tax burden is assessed and borne. Indeed, the elimination of the premium tax would enable the industry to significantly grow, which could lead to greater total industrywide tax payments.

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Rationalization of separate industries' tax rules does not mean the elimination of the industry's products' tax privileges. After all, the industry does not pay the premium tax to obtain or "to buy" its products' tax privileges. The products' tax privileges arise from a product's role in society, and it can be confidently defended upon such grounds.

Some may suggest that the industry's average 1.9% premium tax is not that great a burden, that it is readily overcome by the product's tax-deferred privilege. Others might mention that insurers receive tax credits and guaranteed fund assessments credits for premium taxes paid as a rationale for not working to change the system. But marketing is supposed to eliminate the need for salespeople to demonstrate such mathematical proofs or their need to cite such an irrational system's convoluted quirks as part of such an excuse.

Quite simply, these are not good enough reasons for providing cash-value critics a place to hang their hats. Such responses confuse the issue by ignoring the paramount question: Why accept a continuation of this unfair tax? Life industry executives, like their counterparts in other industries, are responsible for their products' input costs. While the industry's inadequate disclosure practices have facilitated neglect of such cost control and structural issues, such neglect should continue no longer. BR