

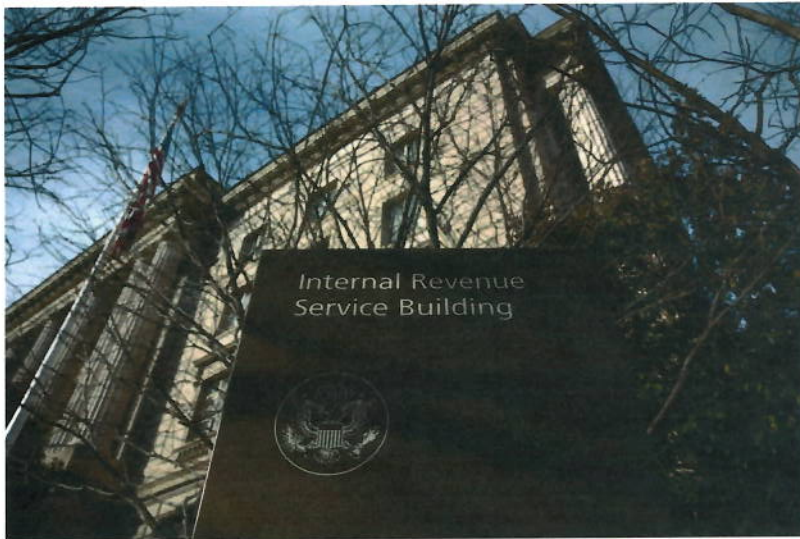
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MARKETS

A Small Tax Change Is a Boon for Permanent Life Insurance

Insurers worried that a government rule from 1984 threatened certain products—and sought Washington's help



A change by Congress will generally increase the amount of money that policyholders can contribute to their so-called cash-value accounts.

PHOTO: SAMUEL CORUM/BLOOMBERG NEWS

By [Leslie Scism](#)

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Federal lawmakers' big year-end spending package includes a little-noticed revision of the tax code that is likely to boost sales of life insurance, particularly for wealthy Americans.

The law lowers a minimum interest rate used to determine whether combination savings and death-benefit policies known as permanent life insurance are too much like investments to qualify for tax advantages granted to insurance. The interest-rate floor was put in place in 1984 to weed out policies that were mostly investment vehicles with a

thin layer of insurance. Lowering the rate allows owners to put more in the savings portion.

And it makes it more feasible for insurers to offer policies, since rates have tumbled so far in the past decade that the 1980s-era minimum limit is now well above long-term government-bond yields. That has led insurers to warn they might quit selling some of the policies.

The reduction in the interest-rate assumption was effective Jan.1 on new sales.

WSJ NEWSLETTER

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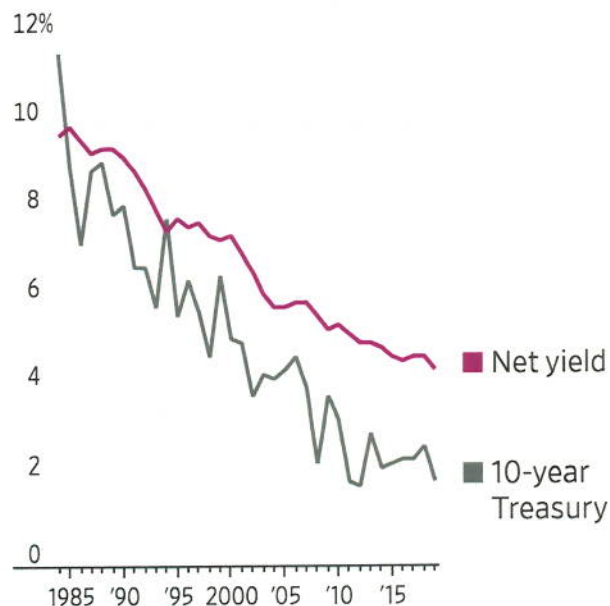
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A summary by the U.S. House staff said the revision was necessary “to reflect economic realities” and give consumers “access to financial security via permanent life-insurance policies.”

“It will create some new opportunities for clients,” said Katie Nentwick, a managing director at Long Road Risk Management Services LLC in Phoenix, which assists investment advisers with arranging and managing insurance plans.

Owners of permanent-life policies defer taxes on their investment gains, and their beneficiaries receive the death benefit tax-free. The policies are designed to be in place for a buyer’s entire life, and allow a buyer to accumulate money to help fund the policy’s future costs and to tap prior to death.

U.S. life insurers' investment-portfolio net yield



Sources: A.M. Best (net yield); Ryan ALM, Tradeweb ICE Closes (10-year Treasury)

The year-end change by Congress will generally increase the amount of money that policyholders can contribute to their so-called cash-value accounts, though some restrictions remain. This change applies to buyers of all income levels, though wealthier people would typically be better able to afford extra payments into a policy.

“Given the impending rise of income-tax rates, this represents a unique opportunity for high-net-worth investors and investment advisers,” Ms. Nentwick said. She said it could take months to know details of how it will play out, as many insurers must redesign products and obtain regulatory approvals.

An analysis by the Joint Committee on Taxation in May showed that the lower interest-rate assumptions could reduce federal income-tax revenue by about \$3.3 billion over 10 years.

In establishing the 1984 rule—known as Section 7702—Congress was seeking to identify investment products disguised as life insurance to obtain the favorable tax treatment, according to industry historians. It also could root out policyholders wrongly stuffing huge sums of money into policies to avoid tax bills.

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What do you see as being the major implications of this change in the IRS code? Join the conversation below.

In simple terms, the 1984 tax code adopted an assumption of a guaranteed 4% growth rate in cash value for a policy to enjoy the tax advantages. Industry executives said this rule had become especially problematic for whole life, a subset of permanent life popular with middle-income families and small-business owners.

Life insurers earn part of their profit by investing customers' premiums until needed for payouts, and their investment portfolios are heavy with high-quality bonds. Insurers' portfolio yields have declined since a peak in 10-year Treasury yields at nearly 16% in the 1980s. The 10-year Treasury currently yields just over 1%.

After a pandemic-related dive early in 2020, trade group American Council of Life Insurers lobbied Congress to switch to a floating interest rate, said Paul Graham, the organization's senior vice president of policy development. Lobbyists also included Finseca, a profession-based trade association.

Insurers' investment yields "dropped to the point they were bumping right up against their ability to pay that 4% interest rate on their policies, and they faced a dilemma," Mr. Graham said. Without a tax-code change, "whole life as we knew it would be severely compromised and may no longer exist," he said.

Under the change approved by Congress, the tax-code interest rate will be 2% this year and then it will float, Mr. Graham said.

Already some agents and brokers are talking up sales possibilities.

Anthony Mento, president of LIFE Brokerage LLC in Hammonton, N.J., dispatched a video to agents who use his firm's services. In an interview, he said the change "is a big win for consumers and carriers."

"The Section 7702 Christmas miracle" is how Bobby Samuelson, president of Life Innovators LLC, a life-insurance and annuity product-development company, sums up the

lobbying effort. It positions life insurance “to survive and even thrive in an ultra-low-interest-rate environment,” he said.

Write to Leslie Scism at leslie.scism@wsj.com

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