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Complex PPACA tax could benefit life insurance industry

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There may be a boon in the Patient Protection and Affordable Care Act (PPACA) for the life insurance industry due to complexities for taxpayers under a new investment tax within it.

Whole life insurance policies could become very attractive investments while annuities – along with growth stocks – will likely be used more extensively under a tax mechanism in the health care reform law called the Net Investment Income (NII), according to the Congressional testimony of a tax academic today in Congress.

Retirement accounts may also get a boon from the new tax, according to today's testimony.

David Kautter, managing director of the nonpartisan Kogod Tax Center, of the American University's Kogod School of Business, testified before the Subcommittee on Oversight of the Committee on Ways and Means on the tax provisions contained in PPACA.

Kautter, a former director of national tax for Ernst & Young, was speaking of an expectation of changing taxpayer behavior to deal with the NII.

Kautter focused his testimony on what he said were two of the most significant provisions in the Act on revenue and reach, the new Medicare tax on wages and the 3.8 percent tax on NII.

From a tax planning perspective, taxpayers will be focused on simultaneously managing two entirely new calculations in the Internal Revenue Code, he said. They are:

1. Modified Adjusted Gross Income, MAGI or "threshold planning;" and
2. The NII.

The rate of the 3.8 percent tax is the lesser of an individual's investment income for the taxable year or the excess of the MAGI over the threshold amount, which varies on income and status.

Trying to comply and work with the more complex implications of the NII could take hundreds of thousands of hours on the part of American taxpayers, Kautter predicts.

For starters, if a taxpayer will likely be under the threshold in a particular year, planning will focus on increasing NII to utilize the full amount of the threshold.

If a taxpayer will likely be over the threshold, planning will focus on minimizing NII for that year, he explained.

Thus, investments in whole life and municipal bonds that not only do not count in MAGI but do not count as NII will become very attractive, Kautter stated to the panel.

Retirement planning will also take on new scrutiny under the NII tax, he said.

Distributions from retirement vehicles such as qualified retirement plans and IRAs are excluded from the definition of NII and will become more attractive, Kautter added.

Also, the news may be good for employees with retirement accounts: Some smaller employers and others may be more inclined to contribute more to plans in certain years to reduce MAGI on the year of contribution and receive distributions in a way to minimize the amount of NII subject to tax in a later year, he said.

Investments that defer inclusion in MAGI for extended periods of times will likely be used more extensively, he said, specifically annuities and growth stocks.

With all of this tax change, capital gains planning will take on more importance.

For example, timing the recognition of capital gains will allow taxpayers to control both their MAGI and the NII, while matching capital gains with capital losses will also take on greater importance he said.

Taxpayers may use the installment method of accounting to allow them to avoid large spikes in MAGI in the year of the same and also allow them to better control the amount of NII realized each year thereafter, he stated.

"The President's health care law imposes a number of new taxes and reporting requirements on individuals and various industries – and many of those tax hikes hit the middle class," said panel Chairman Dr. Charles Boustany, R-La., in announcing the hearing. "As the committee moves forward with comprehensive tax reform, it is imperative that we examine the law's tax provisions and consider their impact on the administration of the tax code as well as on individuals, families and employers."

According to the Government Accountability Office (GAO), PPACA contains 47 tax or tax-related provisions, according to Ways and Means.

Estimates by the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) confirm that tax increases associated with the law total more than $1 trillion over the next 10 years. Many of these provisions are already in effect, and others will become effective in 2014. Key provisions include:

- A tax on medical device and drug manufacturers, and health insurers;
- A tax on individuals and families who do not purchase government-mandated health insurance;
- A tax on employers who do not offer government-mandated health insurance;
- Additional Medicare taxes; and
- Taxes on investment income.
