Use Obamacare Tax Increases to Sell Life Insurance and Annuities Before Year-End

Part II

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In the first part of this article we discussed the tax pitfalls of:

- Triggering the 3.8% OMIT (Obamacare Medicare Investment Tax)
- Being pushed into the new 36% and 39.6% income tax brackets
- Increasing Medicare premiums by as much as $3,434 per year per person
- Having the adjusted gross income (AGI) limitation on itemized medical expenses jump from 7.5% to 10% because the Bush tax cuts will expire at the end of 2012
- Triggering the alternative minimum tax with higher AGI
- Including up to 85% of Social Security income in taxable income

In this part we will discuss how we can use life insurance and annuity products to help mitigate these onerous taxes and premiums.

Solutions for People Not Needing to Live on Income From Investments

Reallocating assets into life insurance policies has three potential benefits:

- Possible mitigation of the tax issues listed above
- Cash accounts available if needed
- Legacy planning for kids and charities

As we all know, life insurance can be designed to maximize wealth transfer to the kids or charities of the donor's choice. Or it can be designed to build cash values in combination with leaving very significant wealth to the kids or charities.

The tax-deferral attributes of cash value life insurance may reduce the amount of modified adjusted gross income reported on the tax return, thereby mitigating part of or the entire rogue's gallery of taxes listed above. And of course if assets are managed well, the client can access cash values on a tax-deferred or tax-free basis during life. And in most cases the kids or charities get the life insurance proceeds income tax-free and possibly estate tax-free.

Solutions for People Needing Income to Live on From Their Investment Assets

When clients need income immediately, they may want to use a combination of annuities. This is also true if they are not interested in leaving a legacy to someone or to a charity. Or if they do want to leave a legacy to someone but cannot qualify for life insurance, this could work too.

In a recent article, "How can line 20(b) help you sell more annuities?" I discuss modernizing an old concept known as either "combination annuities" or "split annuities." This strategy focuses on providing current income while reducing taxes overall. In that article we talked about helping people in retirement reduce or eliminate taxation of Social Security income. The demographic focus was mostly middle-income families.

For purposes of this article we would use the same technique to potentially reduce Medicare premiums or the new 3.8% OMIT. It may also drop the client into a lower income tax bracket.

The strategy suggested is discussed more completely in the article referenced above. It suggests the combination of immediate annuities with deferred annuities to provide current income and tax deferral. A portion of the premiums is put into an immediate annuity to provide income for five years. The remainder is put into several deferred layers of fixed or indexed annuities. When the five-year immediate annuity runs out, another one of the deferred annuities is annuitized until it runs out, and we repeat the process. Finally, after all the other deferred annuities are annuitized, the indexed annuity with a lifetime income rider starts its guaranteed withdrawal process. The base income on that contract will have grown substantially over the years and the client's now-advanced age will allow for even better guaranteed lifetime distributions under the withdrawal formulas.

This structure maximizes the amortization of tax basis while deferring taxes into the future, thereby helping to mitigate the taxes we are trying to reduce or avoid. It also has the important advantage of allowing the interest rates to rise every five years if we find ourselves in an inflationary trend. And the layering of annuities can be designed to provide increased income along the way by adjusting the amount of premiums allocated to each layer of annuities. Doing so reduces the up-front income but allows more money to be invested in the other deferred annuities to provide income later to combat inflation.

The layering uses shorter-term deferred annuities, which keeps early withdrawal penalties low. This may be more appropriate than longer penalty periods for retirees. At the end of each five-year period new contracts with better rates could be put in place with no penalties being incurred on the original deferred annuities, with the exception of the indexed annuity with a lifetime income benefit rider.

Working With CPAs to Make the Sale and Obtain Referrals

The strategies suggested in this article to mitigate the increase in taxes are perfect ways to build relationships with CPAs. Insist that clients include their CPAs in the planning process. Tell them that there may be thousands of dollars in potential tax savings and that the only accurate way to know how it will affect them is to run a tax projection with and without your planning advice.

You need not be afraid of the CPA, because these concepts are effective and legitimate. Bringing the CPA to the table does a whole bunch of good things. First, you will increase the client's trust because the client will see you are not afraid of the CPA's scrutiny and secondly, the CPA will see the same thing. You are more likely to be accepted as a trusted team member instead of being put on the defensive. It is better for you to explain the transaction to the CPA than to have the client consult with the CPA without your input. Having the CPA involved may keep you out of regulatory trouble too because of the independent representation of a fee-only advisor. And remember that you are not allowed to give tax advice, nor does your E & O insurance cover you for that! And best of all, you may find the CPA wants to use these concepts with other clients. It is the CPA's job to save clients taxes. These strategies do that. At the same time they generate billable time for the CPA for doing the necessary tax projection work. In most cases the tax savings should more than pay for the time. Everyone wins, and the transaction is clean.

Think about it. We all want to build relationships with CPAs, and we struggle to gain access. This is a great way to meet CPAs on favorable terms. Your client is essentially giving you a warm referral to his or her CPA and even introducing you in person!

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