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Subject: **President's Economic Recovery Advisory Board ("PERAB")
Suggests Review of "Tax Expenditures" for Inside Build-up on Life
Insurance Savings**

Major References: [*Report of the President's Economic Recovery Advisory Board on Tax Reform Options: Simplification, Compliance and Corporate Taxation \(August 2010\)*](#)

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THE CONCLUSION OF THIS WASHINGTON REPORT.**

The recently released "Report on Tax Reform Options" issued by the President's Economic Recovery Advisory Board (sometimes referred to as "PERAB"), headed by former Federal Reserve Board Chairman Paul Volker, includes among a list of corporate so-called "tax expenditures" the "exclusion of interest on life insurance savings" - i.e., the inside build-up on life insurance contracts. (See the PERAB's Report's Table 9 on page 77.)

The "tax expenditure" concept is understood to have first been articulated by a U.S. Treasury Assistant Secretary for Tax Policy in the early 1960s during John Kennedy's Administration. In general, it may be described as revenue foregoing by the government as the result of provisions in the Internal Revenue Code that allow (i) deductions, exclusions and exemptions from a taxpayer's income, (ii) deferrals of that income or (iii) tax rates on that income which are lower than normally imposed on other similar income of that taxpayer or other taxpayers. According to the PERAB Report, tax expenditures that are specific to corporate taxpayers "narrow the tax base for certain businesses, with the result that higher statutory rates are needed to achieve the same revenue." The Report continues with its (in the view of many, debatable) snapshot of corporate tax expenditures:

“Many of these provisions distort economic activity, increase the complexity of the tax code, and violate principles that businesses with similar characteristics should be treated equally. Eliminating specific expenditures would thus improve efficiency while simplifying the tax code. Many of the disadvantages of elimination are specific to the proposals; elimination will disadvantage those who benefit from the tax expenditure.”

Among the largest of these are the deduction for U.S. production/manufacturing activities and the research and experimentation (R & E) tax credit, which together, as set forth in the Report, account for a total projected 10 year revenue loss in FYs 2008-2017 of approximately \$390 billion. The exclusion of “interest on life insurance savings” is number four on the Report's list of potential corporate tax expenditure targets, with a potential revenue loss of \$30 billion over the same period. The Report, without further explanation, does not include any potential revenue loss from individual taxpayers in this category. We assume, without knowing precisely, that the Report may be viewing the initial direct advantage from the tax expenditure as inuring solely to the policies-issuing life insurance companies and not to the recipient (corporate or individual) policy owners. It also may be that \$30 billion number relates only to recipient corporate policy owners and not to the issuing life insurance companies. In any event, it is a sizable number of meaningful federal fiscal consequence.

We stress that the inclusion of the inside-build up of life insurance contracts in the tax expenditure list is not new. Over the years it has been proposed by many governmental authorities (e.g., the Treasury and the Congressional Joint Committee on Taxation). However, there is no explanation included in the text of the Report that would aid in understanding the reasoning behind its specific inclusion. A number of other “options” are included - and explained in much detail - to describe what the Report claims will achieve the following three broad goals: simplifying the tax system, improving taxpayer compliance, and reforming the corporate tax system.

It is AALU's long held view (set forth over many years) that the tax expenditure concept as applied to life insurance, is, for the most part, a flawed one and that the current federal income tax treatment of “interest on life insurance savings”, as that term is used in the Report, is totally appropriate and should not be changed.

AALU will shortly issue another AALU Washington Report on the PERAB’s separately stated options for simplifying savings and retirement incentives, which are addressed at length in its Report.

Any AALU member who wishes to obtain a copy of the *PERAB Report on Tax Reform Options: Simplification, Compliance and Corporate Taxation* may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org, enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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