

7702 Managed Accounts

With interest rates increasing, it has been getting easier to obtain high yielding investments. I recently attended several different investment conferences, and at each one there has been quite a bit of enthusiasm for private credit funds. These are funds of secured short term floating rate loans made to large companies across the country. They are currently yielding about 10% per year and are attractive because they not only have historically been one of the best performing debt assets classes, but they have also had extremely low volatility and very low drawdowns compared to traditional bonds. The downside is that all the income is taxable each year. Similarly structured index notes and mortgage REITs can also produce double digit yields. Income from structured notes and mortgage REITs are also taxed as ordinary income although the mortgage REITs get 20% tax deductions on the income. Additionally, many investors have recently made some sizeable gains in the stock and private equity markets. Those gains will be taxed as either short term or long-term capital gains. One popular way to avoid income tax on one's investments is through a 7702 account. 7702 is the section of the IRS code that blesses life insurance with enormous tax benefits. By wrapping a life insurance policy on an investment account investor can avoid paying any taxes on interest income, dividends, or long or short-term capital gains. This strategy can be used to shelter investments of practically any kind. These can include not only traditional stock and bond market investments but private investments, hedge funds, private equity and real estate funds as well. Although there is an annual cost to create a life insurance wrapper on a 7702 managed account, the tax savings will generally be about 4 times the insurance costs. This can be especially beneficial for investments in an irrevocable trust because there is no longer any step up in basis in an irrevocable trust and trusts are taxed at very high levels. However, all proceeds of a 7702 account are tax free one's death even in an irrevocable trust.