Robin & Peter on LIFE SETTLEMENTS

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Tax Bill Would Impact Life Settlements and More

Senator Robert Casey (D-PA) has introduced a new tax bill, S 2048, that addresses the tax reporting requirements for life insurance policies sold and the death benefits paid under those policies. It also tightens the transfer for value rules and improves the seller's cost basis calculation for life settlements.

The reporting and transfer for value implications of the bill apply to "reportable policy sales" which is defined to include most non-gift transfers of life insurance policies "if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract." This definition includes, of course, life settlements. In addition, direct sales and indirect sales, through a trust or business entity, for example, are all included.

Reporting Requirements
If a policy is transferred through a "reportable policy sale" then both the acquirer and the issuing insurance company are subject to additional reporting requirements which include identifying information about the policy, purchaser, seller and insurance company, sales price, and investment in the contract. Additionally, upon death, the insurer would have to report the death proceeds paid on such policies.

Transfer for Value
The transfer for value rules would also be tightened by the proposed bill. If a policy is sold in a "reportable policy sale" then an additional requirement is imposed to qualify for one of the transfer for value exceptions. The acquirer of the policy would have to also have a substantial family, business or financial relationship with the insured apart from the policy itself. This would eliminate a loophole in the current transfer for value rules where, for example, one could qualify for an exception to the transfer for value rules if both the insured and acquirer owned a single share of a publicly traded partnership. Technically, under current law, they would be partners and would qualify for the partnership exception.

Tax Basis Relief

Here's the good news! The bill also overturns the IRS's poorly reasoned and unworkable ruling in Rev. Rul. 2009-13 which reduced the seller's tax basis in a life settlement transaction by the cumulative Cost of Insurance (COI) charges. *The new law would allow the seller to include all premiums paid without reduction for COI charges.* This would essentially give the seller the same tax basis whether the policy was surrendered or sold in a life settlement. Others who might also be caught by the basis rule of Rev. Rul. 2009-13, like employers that bonus or sell an existing policy to an employee, or partners or shareholders that transfer policies to each other would also benefit from this provision. This part of the law would be retroactive to August 25, 2009 (when Rev. Rul. 2009-13 took effect), while the rest of the law would apply to transactions occurring after December 31, 2012.

At this early stage it is anyone's guess if the bill will become law, but it is encouraging to know that the conversation has started in Congress to correct the damage caused by Rev. Rul. 2009-13. Relief may be on its way!

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