

Robin & Peter on LIFE SETTLEMENTS



May 9, 2017

Proposed Tax Bill Would Clarify Tax Treatment of Life Settlements

In May of 2009, the IRS issued Revenue Ruling 2009-13 addressing the tax implications of a life settlement to the seller of a life insurance policy. H.R. 1262 was recently introduced to remedy the shortcomings of this revenue ruling.

In the 2009 ruling, the IRS created a distinction in the tax basis between policies that are surrendered and policies that are sold in a life settlement. For policies that are surrendered at a gain, the law has long been that the policy owner's basis is their cumulative investment in the contract, which is basically the cumulative premiums paid less withdrawals and dividends taken from the policy. But for purposes of a life settlement, the IRS ruled that the basis would have to be reduced by the cumulative cost of insurance charges assessed against the policy. For no apparent reason, the ruling puts the seller in a life settlement transaction in a less favorable tax position than someone who surrenders a policy.

Furthermore, the ruling created a number of unanswered issues with respect to the tax treatment of a life settlement transaction to the seller:

1. Since insurance companies are not required to track cumulative cost of insurance charges, what is a seller to do if the information is not available?
2. What is the tax basis of whole life policies which do not have explicit cost of insurance charges?
3. Since it is mathematically possible for cumulative cost of insurance charges to exceed cumulative premiums, can a policy have a negative tax basis?
4. What is the basis of a policy that had been previously subject to a 1035 exchange?
5. The broadly worded language of the ruling could be applied to a situation where a business transfers a key employee policy to the employee.

H.R. 1262 provides long awaited relief, solving all these problems by eliminating

the requirement to reduce the seller's tax basis by the cost of insurance charges. Essentially, the seller in a life settlement transaction would have the same tax basis as someone who surrendered a policy. This relief would be retroactive to August 25, 2009, which was the effective date of Revenue Ruling 2009-13. In addition, the proposal would also clarify the reporting requirements for all parties to a life settlement transaction including the issuing insurance company.

Hopefully Congress will act quickly on the proposal as relief from the poorly reasoned and problematic Rev. Rul. 2009-13 is long overdue.

Contact us:

Robin S. Weinberger, CLU, ChFC, CLTC

(617) 451-3343

Peter N. Katz, JD, CLU, ChFC

(860) 539-4526

© 2017 Peter N. Katz. All rights reserved.

Robin and Peter, 220BoylstonStreet,#1204,Boston,MA