

# Transfer for value/reportable policy sales regulations overview

The general rule for life insurance is that the death benefit is received income tax-free by the beneficiary.<sup>1</sup> However, there are several exceptions, including the long-standing “transfer for value” rules.<sup>2</sup> A transfer for value of a life insurance policy or any interest in such a policy without an exception will generally cause the death benefit to be taxable income to the beneficiary. The taxable amount is reduced by the consideration paid for the policy and subsequent premium payments.

Exceptions to the transfer for value rules include transfers to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer. In addition, there’s an exception for transactions in which the new policy owner (transferee) receives a carryover basis from the current policy owner (transferor). These exceptions are heavily relied upon when life insurance policies are sold or otherwise transferred for value from one party to another.

A reportable policy sale,<sup>3</sup> generally intended to mean the commercial transfer of a life insurance policy (e.g., a life settlement),<sup>4</sup> represents another instance where the death benefit may become subject to income tax. A reportable policy sale is defined as the acquisition of a life policy, directly or indirectly, in cases where the transferee has no substantial family, business, or financial relationship with the insured, independent of the transferee’s interest in the life insurance policy being transferred. The transfer for value exceptions discussed above are *not* available for reportable policy sales.

Final regulations covering these rules are complex, but generally fair, with the Treasury Department providing reasonable interpretations of what might be considered a family, business, or financial relationship with the insured apart from an interest in the life policy. For many transfers that aren’t commercial transfers, there will be a substantial family, business, or financial relationship with the insured, independent of the life policy being transferred. In such cases, the reportable policy sale rules would not cause the death benefit to be income taxable.

Particular care should be exercised for business mergers and acquisitions where life insurance policies are directly or indirectly being transferred. In some cases, such transfers may be considered reportable policy sales, even though no life settlement is involved. Fortunately, some of the exceptions described above may prevent the death benefit from becoming taxable in such situations. For details on these exceptions, check out [this Q&A](#).

A high-level overview of important exceptions is provided below:

- If properly structured, a buy-sell agreement between the insured and acquirer of the life policy will generally result in a substantial financial relationship between the insured and the acquirer.
- In many business acquisitions where the acquiring company is carrying on a trade or business that doesn’t include investing in life insurance, the relationship of the insured as an employee of the acquired company will generally cause the transaction to fall within the substantial business relationship exception.

- For any individual, relationships that constitute a substantial family relationship under the regulations include the individual, the individual's spouse, parents, grandparents, great-grandparents, and any lineal descendants (and spouses of such lineal descendants, as well as the lineal descendants of the spouses) of the individual. It doesn't include siblings of the individual or the children of siblings.
- The impact of a 1035 exchange on reportable policy sales was clarified in proposed regulations issued in 2023<sup>5</sup>. Clarifying an unintended implication of earlier regulations, the proposed rules essentially conclude that a 1035 exchange neither cures nor creates a reportable policy sale. Instead, the attributes of the policy being exchanged apply to the policy received in the exchange.

Under IRC Section 6050Y, every person or entity who acquires a life policy in a reportable policy sale is required to tax report such transactions under IRS rules. Generally, the acquirer must provide a Form 1099-LS to the IRS. A Form 1099-LS or substitute must also be provided to the issuing insurance carrier and the seller. IRC Section 6050Y also imposes tax reporting requirements on insurance carriers. The insurance carrier is required to provide a Form 1099-SB to the seller and the IRS, reporting the seller's investment in the contract and surrender value of the contract as of the date of the transaction. An insurance carrier who pays death proceeds under a life policy that has been transferred in a reportable policy sale is required to include the reportable death benefit and estimated cost basis (investment) in the life policy on a Form 1099-R.

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<sup>1</sup> IRC Sec. 101(a)(1), Under the final regulations, a transfer for value is defined as a transfer of an interest in a life insurance contract for cash or other consideration reducible to a money value.

<sup>2</sup> IRC Sec. 101(a)(2)

<sup>3</sup> IRC Sec. 101(a)(3), added by the Tax Cuts and Jobs Act of 2017.

<sup>4</sup> The sale of life policy to a life settlement or viatical company would be an example of a commercial transfer.

<sup>5</sup> See Prop. Regs. §§1.101-1(b)(2)(iv), (c)(2)(v) and (c)(3).



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