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Legislative Update

New Rules for "Reportable Policy Sales"

February 2018

New Rules for "Reportable Policy Sales" May Impact Life Insurance Policies Acquired in Corporate Transactions

Death benefits from life insurance generally are not taxable to the beneficiary(ies) of the insurance policy. However, if a policy has been transferred for "valuable consideration," the death benefit in excess of cumulative premiums is taxable. This "transfer for value" may occur, for example, if a person or entity purchases life insurance policies from another person or entity in an asset sale.

There is an exception to the "transfer for value" rule, however, that maintains the tax free status of all death benefits under a policy when a purchaser acquires life insurance policies in a transaction in which the tax basis in the acquired policies is determined, in whole or in part, by reference to the seller's tax basis in the policies. This tax carryover will occur in many types of corporate acquisitions, thereby preserving the tax-free death benefits of policies in such acquisitions.

A provision in the Tax Cuts and Jobs Act, however, casts a shadow over these types of corporate tax carryover acquisitions. Under the new law, if a transfer of a life insurance policy is a "reportable policy sale," then the tax carryover exception to the "transfer for value" does not apply and any death benefit received over the tax basis would be taxable.

A "reportable policy sale" occurs when an acquirer of a life insurance policy has no substantial family, business, or financial relationship with the insured. In the case of a corporate acquisition, the acquirer would have a business relationship with those insureds who remain with the acquiring company after the corporate transaction. However, when there are policies insuring former employees, officers or directors, it can be argued that there is no business relationship; the transfer of those policies may fit the definition of "reportable policy sale," triggering potential taxation of death benefits under the "transfer for value" rule.

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It is our understanding that this provision was not intended to apply to policies transferred in corporate transactions, and there are efforts ongoing in Washington to ensure policies insuring former employees, officers and directors maintain their tax-free death benefit status as was the case prior to the enactment of the Tax Cuts and Jobs Act. M Benefit Solutions will continue to monitor these efforts and we recommend clients going through acquisitions and mergers consult with counsel on the impact of the Tax Cuts and Jobs Act to the taxation of death benefits.

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