

# TaxNewsFlash

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## Proposed regulations: Life insurance contracts, reportable sales and reportable death benefits

The U.S. Treasury Department and IRS today released for publication in the Federal Register proposed regulations (REG-103083-18) as guidance on new information reporting obligations under section 6050Y related to reportable policy sales of life insurance contracts and payments of reportable death benefits.

The [proposed regulations](#) [PDF 308 KB] also provide guidance on the amount of death benefits excluded from gross income under section 101 following a reportable policy sale.

These proposed regulations implement measures that were enacted in December 2017 by the U.S. tax law (Pub. L. No. 115-97) referred to as the "Tax Cuts and Jobs Act," and affect parties involved in certain life insurance contract transactions including reportable policy sales, transfers of life insurance contracts to foreign persons, and payments of reportable death benefits.

Comments are requested, for which the proposed regulations set out a set of issues for which comments are specifically requested. A public hearing has been scheduled for June 5, 2019.

### Background

Section 6050Y imposes information reporting obligations on every person who acquires a life insurance contract (or an interest in a life insurance contract) related to reportable policy sales of life insurance contracts. Additionally, section 6050Y imposes information reporting obligations on every person who makes a payment of reportable death benefits. The proposed regulations set forth definitional provisions and guidance on the reporting obligations imposed by section 6050Y.

### Section 1.6050Y-1: Definitions

Section 1.6050Y-1 of the proposed regulations defines several relevant terms, including acquirer, seller, issuer, 6050Y(a) issuer, 6050Y(b) issuer, reportable policy sale payment, reportable policy sale payment recipient, notice of a transfer to a foreign person, payor, reportable death benefits, and reportable death benefits payment recipient.

## **Section 1.6050Y-2: Reporting of payments by acquirer in a reportable policy sale**

Section 6050Y(a) requires reporting of payments made by an acquirer in a reportable policy sale. Section 1.6050Y-2(a) of the proposed regulations sets forth the requirement of information reporting applicable to acquirers in reportable policy sales under section 6050Y(a)(1) and describes the information that must be reported.

The proposed regulations allow for unified reporting by the acquirers in a series of prearranged transfers of any interest in a life insurance contract. See Prop. Reg. section 1.6050Y-2(b) and (d)(3). A series of prearranged transfers of an interest in a life insurance contract may include transfers in which one or more persons serve as intermediaries

Section 1.6050Y-2(d) of the proposed regulations sets forth the requirement under section 6050Y(a)(2) for the acquirer in a reportable policy sale to furnish a written statement to certain persons. To facilitate proper tax reporting, the proposed regulations therefore provide that an acquirer must furnish a reportable policy sales statement (RPSS) to the 6050Y(a) issuer by the later of: (1) 20 days after the reportable policy sale; or (2) five days after the end of the applicable state law rescission period. See section 1.6050Y-2(d)(2)(ii) of the proposed regulations. However, if the later date is after January 15 of the year following the calendar year in which the reportable policy sale occurred, the RPSS must be furnished by January 15 of the year following the calendar year in which the reportable policy sale occurred. Id. Section 1.6050Y-3(d)(2) of the proposed regulations generally requires that the 6050Y(b) issuer furnish any written statement required by section 6050Y(b)(2) to the seller no later than February 15 of the year following the calendar year in which the reportable policy sale occurs.

## **Section 1.6050Y-3: Reporting of transferor's investment in the contract by section 6050Y(b) issuer**

Section 6050Y(b) requires the issuer to report certain information to the seller, including the seller's investment in the contract. A purpose of section 6050Y is to provide the seller in a reportable policy sale and the IRS with the information needed to determine the seller's taxable income from the sale. In the case of a sale of a cash value life insurance contract, the gain is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered, and any excess is capital gain. See Rev. Rul. 2009-13, 2009-21 I.R.B. 1029.

Section 1.6050Y-3(b) of the proposed regulations provides that a 6050Y(b) issuer's reporting obligation under section 6050Y(b) and Prop. Reg. section 1.6050Y-3(a) is deemed satisfied if the information required by section 6050Y(b) and Prop. Reg. section 1.6050Y-3 is timely reported by any other 6050Y(b) issuer or a third-party information reporting contractor.

To facilitate proper tax reporting, section 1.6050Y-2(d)(2)(ii) of the proposed regulations requires acquirers to furnish a RPSS to the 6050Y(a) issuer by January 15 of the year following the calendar year in which the reportable policy sale occurred, if not earlier, and section 1.6050Y-3(d)(2) of the proposed regulations provides that a 6050Y(b) issuer generally must furnish any written statement required to be provided to a seller no later than February 15 of the year following the calendar year in which the reportable policy sale or transfer to a foreign person occurs.

## **Section 1.6050Y-4: Reporting of reportable death benefits by payor**

Section 6050Y(c) requires payors to report payments of reportable death benefits. Section 1.6050Y-4(c)(1) of the proposed regulations sets forth the requirement under section 6050Y(c)(2) to furnish statements to reportable death benefits payment recipients. To facilitate proper tax reporting, section 1.6050Y-4(c)(2) of the proposed regulations provides that a payor must furnish any written statement required to be provided to a reportable death benefits payment recipient no later than January 31 of the year following the calendar year in which the reportable policy sale occurs. The proposed regulations use January 31 because it is generally the deadline for furnishing copies of Form 1099-R to recipients.

## **Exceptions to reporting under section 6050Y**

The proposed regulations include certain exceptions to the reporting requirements otherwise imposed on acquirers, 6050Y(b) issuers, and payors. These exceptions to reporting are similar in their intended purposes to exceptions included in regulations issued under other sections in chapter 61 that except reporting by certain payors and brokers (as applicable based on the section) with respect to a transaction occurring outside the United States when no nexus of the transaction to the United States is identified (under criteria specified in each of the regulations).

### **Section 1.101-1: Exclusion from gross income of proceeds of life insurance contracts payable by reason of death**

Generally, amounts received under a life insurance contract that are paid by reason of the death of the insured are excluded from federal income tax under section 101(a)(1). However, if a life insurance contract is sold or otherwise transferred for valuable consideration, the “transfer for value rule” set forth in section 101(a)(2) generally limits the excludable amount to the sum of: (1) the actual value of the consideration paid by the transferee to acquire the life insurance contract; and (2) the premiums and other amounts subsequently paid by the transferee. Section 101(a)(2) provides two exceptions to this transfer for value rule. Specifically, the limitation set forth in section 101(a)(2) does not apply if: (1) the transferee’s basis in the contract is determined in whole or in part by reference to the transferor’s basis in the contract; or (2) the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

Under section 1.101-1(e)(3)(i) of the proposed regulations, the transfer of an interest in a life insurance contract results in the direct acquisition of the interest by the transferee (acquirer). Under section 1.101-1(e)(3)(ii) of the proposed regulations, an indirect acquisition of an interest in a life insurance contract occurs when a person (acquirer) becomes a beneficial owner of a partnership, trust, or other entity that holds (directly or indirectly) an interest in the life insurance contract. For this purpose, the term “other entity” does not include a C corporation (as that term is defined in section 1361(a)(2)), unless more than 50% of the gross value of the assets of the C corporation (as determined under Prop. Reg. section 1.101-1(f)(4)) consists of life insurance contracts immediately before the indirect acquisition. Under section 1.101-1(f)(1) of the proposed regulations, a “beneficial owner” of a partnership, trust, or other entity is an individual or C corporation with an ownership interest in that partnership, trust, or other entity. The beneficial owner’s interest may be held directly or indirectly, through one or more other partnerships, trusts, or other entities.

Accordingly, under section 1.101-1(e)(3)(ii) of the proposed regulations, persons that acquire shares in a C corporation that holds an interest in a life insurance contract generally will not be considered to have an indirect acquisition of an interest in such contract. However, if the C corporation primarily owns life insurance contracts (or interests therein), any person that acquires shares in the C corporation will be considered to have an indirect acquisition of an interest in any life insurance contract held by the C corporation.

Newly added section 101(a)(3)(A) provides that these two exceptions will not apply in the case of a transfer of a life insurance contract, or any interest therein, that is a reportable policy sale.

A transfer is not a reportable policy sale when there is a “substantial family relationship,” a “substantial business relationship,” or a “substantial financial relationship.”

- A “substantial family relationship” is the relationship between an individual and any family member of that individual as defined in section 1.101-1(f)(3) of the proposed regulations, and also includes a relationship between the insured and an entity if all of the entity’s beneficial owners have a substantial family relationship with the insured.

- A “substantial business relationship” exists between the acquirer and insured when the insured is a key person of, or materially participates in, an applicable active trade or business, or when the acquirer acquires an active trade or business and acquires the interest in the life insurance contract either as part of that acquisition or from a person owning significant property leased to the acquired trade or business or life insurance policies held to facilitate the succession of the ownership of the business, if certain requirements are met.
- A “substantial financial relationship” exists between the insured and the acquirer when: (1) the acquirer has a common investment with the insured and a buy-out of the insured’s interest in the common investment by the co-investor(s) after the insured’s death is reasonably foreseeable; (2) the acquirer maintains the life insurance contract on the life of the insured to provide funds to purchase assets or satisfy liabilities following the death of the insured; or (3) the acquirer is an organization described in sections 170(c), 2055(a), and 2522(a) that previously received financial support in a substantial amount or significant volunteer support from the insured.

The proposed regulations also specify that the fact that an acquirer is 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 (all relationships that are covered by an exception from the transfer for value rule) is not sufficient to establish a substantial business or financial relationship, nor is such status required to establish a substantial business or financial relationship. See section 1.101-1(d)(4)(ii) of the proposed regulations.

The proposed regulations also clarify that, for purposes of determining whether the acquirer in an indirect acquisition of an interest in a life insurance contract has a substantial business or financial relationship with the insured, the acquirer will be deemed to have a substantial business or financial relationship with the insured if the direct holder of the interest in the life insurance contract has a substantial business or financial relationship with the insured immediately before and after the date the acquirer acquires its interest. See section 1.101-1(d)(4)(i) of the proposed regulations. Accordingly, the acquirer in an indirect acquisition may establish a substantial business or financial relationship with the insured based on the acquirer’s own relationship with the insured or the relationship between the insured and the direct holder of the interest in the life insurance contract.

The proposed regulations also provide several exceptions from the definition of reportable policy sale. The proposed regulations provide that the transfer of an interest in a life insurance contract between certain related entities is not a reportable policy sale. Specifically, a transfer between entities with the same beneficial owners is not a reportable policy sale if the ownership interest of each beneficial owner in each entity does not vary by more than a 20% ownership interest. See section 1.101-1(c)(2)(i) and (g)(10) of the proposed regulations. Also, a transfer between corporations that are members of an affiliated group (as defined in section 1504(a)) that files a consolidated U.S. tax return for the tax year in which the transfer occurs is not a reportable policy sale. See section 1.101-1(c)(2)(ii) of the proposed regulations.

### **Applicability dates**

The rules in section 1.101-1(b) through (g) of the proposed regulations are proposed to apply, for purposes of section 6050Y, to reportable policy sales made after December 31, 2017, and to reportable death benefits paid after December 31, 2017. For any other purpose, section 1.101-1(b) through (g) of the proposed regulations apply to transfers of life insurance contracts, or interests therein, made after the date the Treasury decision adopting these regulations as final regulations is published in the Federal Register.

The rules in section 1.6050Y-1 of the proposed regulations are proposed to apply to reportable policy sales made and reportable death benefits paid after December 31, 2017. The rules in sections 1.6050Y-2 and 1.6050Y-3 are proposed to apply to reportable policy sales made after December 31, 2017. The rules in section 1.6050Y-4 are proposed to apply to reportable death benefits paid after December 31, 2017. See section 1.6050Y-1(b) of the proposed regulations.

For reportable policy sales and payments of reportable death benefits occurring after December 31, 2017, and before the date final regulations are published in the Federal Register, the proposed regulations provide transitional relief.

### **KPMG observation**

The proposed regulations cover reportable policy sales, both in terms of information to be provided to the IRS and the treatment of death benefits received in certain transfers for value of a life insurance contract, pursuant to legislation added by the Tax Cuts and Jobs Act (TCJA). The proposed regulations clearly define which policy sales must be reported, and the information that must be included in the information return filed with the IRS. The implementation of reporting both domestic and foreign policy sales is not expected to be overly onerous. However, parties involved in reportable policy sales will need to determine that they have the needed information available and be cognizant of the reporting rules.

The TCJA added section 101(a)(3), which expanded the definition of a transfer for value when a life insurance policy is acquired, directly or indirectly, by an acquirer who does not have a substantial family, business or financial interest in the insured person. This change affected corporate acquisitions of companies that owned life insurance on their employees (i.e., business owned life insurance). If the business owned life insurance covers former employees, the transfer for value rule would apply and the death benefits received on those lives would be subject to tax. The proposed regulations exclude from the transfer for value rules indirect acquisitions between C corporations, as long as no more than 50% of the C corporation's assets consist of life insurance contracts immediately before the acquisition. This would be expected to allow the majority of corporate acquisitions of companies that hold business owned life insurance to remain exempt from the transfer for value rules.

For more information, contact a KPMG tax professional:

Sheryl Flum | +1 202 533 3394 | [sflum@kpmg.com](mailto:sflum@kpmg.com)

Fred Campbell-Mohn | +1 212 954 8316 | [fcampbellmohn@kpmg.com](mailto:fcampbellmohn@kpmg.com)

William Olver | +1 617 988 1642 | [wolver@kpmg.com](mailto:wolver@kpmg.com)

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