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Final Regulations Under Sections 101 and 6050Y

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Authors' note: As the following article describes, the final regulations published on Oct. 31, 2019, provided either an exemption or an extended deadline for information reporting requirements related to certain transactions occurring from Jan. 1, 2018, through Oct. 31, 2019. While this article was in the editing and production process, on Dec. 12, 2019, the Treasury Department and the Internal Revenue Service ("IRS") released "corrections" to the final regulations, extending these relief provisions to additional transactions and making certain other changes. See 84 Fed. Reg. 68042-68043 (Dec. 13, 2019).

The final regulations under section 6050Y, as corrected, apply to reportable policy sales made, reportable death benefits paid, and any notice of a transfer to a foreign person received, in each case after Dec. 31, 2018, thus extending the original exemption for 2018 to include notice of a transfer to a foreign person. Additionally, the extended reporting deadlines (including the extended Feb. 28, 2020, deadline for insurers to furnish Forms 1099-SB and 1099-R to recipients) apply for reportable policy sales and payments of reportable death benefits occurring throughout calendar year 2019, as well as to any notice of a transfer to a foreign person received during calendar year 2019, thus extending the original transition relief to include notice of a transfer to a foreign person and to include November and December activity.

Members of the life insurance industry greatly appreciate the IRS and Treasury's willingness to reconsider the details of these relief provisions in order to facilitate a successful implementation of the new reporting regime.

On Oct. 25, 2019, the Treasury Department ("Treasury") issued Treasury Decision 9879, which provides final regulations under sections 101 and 6050Y¹ regarding transfers for value of life insurance policies and tax reporting requirements with respect to such transfers.² We previously provided a detailed discussion of the proposed regulations in the October 2019 issue of *TAXING TIMES*. The present article focuses on revisions that were made to the proposed regulations, many of which were in response to comments submitted to the Internal Revenue Service ("IRS") and Treasury by the life insurance industry and other interested parties.

As background, the transfer-for-value rule of section 101(a)(2) generally limits the exclusion of the death benefit from taxable income where a life insurance policy is transferred for value to the sum of the consideration paid for the policy by the transferee/acquirer, including premiums that are paid by the transferee/acquirer after the transfer. However, two exceptions set forth in sections 101(a)(2)(A) and (B) provide relief from this rule where the transferee's tax basis in the policy is determined in whole or part by reference to such basis in the hands of the transferor (the "Carryover Basis Exception") and where 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 (the "Related-Party Transfer Exception"). Section 101(a)(3)(A), however, which was enacted by the Tax Cuts and Jobs Act of 2017 ("TCJA")³ provides that these two exceptions will not apply in the case of a transfer that is a "reportable policy sale" ("RPS"). For this purpose, an RPS is defined by section 101(a)(3)(B) as "the acquisition of an interest in a life insurance contract, directly or indirectly, 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."⁴

The TCJA also enacted section 6050Y, which imposes reporting requirements on the acquirer of a life insurance policy or interest therein in an RPS, on the issuer of a policy receiving notice of an RPS or of the transfer of a policy to a foreign person, and on the payor of reportable death benefits under a policy that previously was involved in an RPS.

SECTION 6050Y REPORTING REQUIREMENTS

As described in our earlier article, the proposed regulations provided additional detail on the three reporting requirements under section 6050Y. Numerous comments were submitted in response to the proposed regulations, and the discussion in this article addresses the changes made in the final regulations with respect to those comments, as well as certain areas where requested changes were not made. The discussion first covers more general aspects that affect multiple reporting requirements (such as applicability dates and gratuitous transfers), followed by other details specific to one of the reporting requirements. Our earlier article should be referenced for aspects of the regulatory guidance that were not altered.

Applicability Dates and Transition Relief

One of the major changes made in the final regulations was to eliminate the reporting requirements under section 6050Y for RPSs made and reportable death benefits paid during calendar year 2018. The final regulations apply only to such transactions occurring after Dec. 31, 2018.⁵ Further, death benefits paid in future years are subject to the reporting requirements of Treas. Reg. section 1.6050Y-4 only if the contract or an interest therein

was transferred in an RPS after Dec. 31, 2018; *i.e.*, contracts or interests acquired during 2018 in a transaction that meets the statutory definition of an RPS in section 101(a)(3)(B) remain exempt from the section 6050Y(c) reporting of subsequent reportable death benefits in future years, unless another RPS occurs after Dec. 31, 2018.⁶

Additionally, for RPSs made and reportable death benefits paid Jan. 1 through Oct. 31, 2019, the deadlines for furnishing Form 1099-SB (or a substitute statement) to the seller and for furnishing Form 1099-R (or a substitute statement) to the recipient of reportable death benefits were extended to Feb. 28, 2020 (120 days, rather than 90 days in the proposed regulations, after the date the final regulations were published in the Federal Register), in response to comments received.

It is worth noting that the final regulations did not refer to transfers to a foreign person in the discussions of applicability dates and transition relief, so these would apparently still be subject to reporting on Form 1099-SB for transfers occurring in 2018 and to the standard deadlines (which, of course, have already passed for transfers occurring in 2018).⁷ As of the date of this writing, personnel at the IRS have indicated informally that the omission of transfers to a foreign person in these provisions was not intentional and could be remedied; readers are urged to monitor subsequent guidance, including potential amendments to the final regulations, for this item.

In addition to the transition relief for transactions that occurred prior to issuance of the final regulations, several commenters had requested ongoing penalty relief in various forms (such as permission for an indirect acquirer to make a “good faith effort” to comply with Form 1099-LS requirements if the direct owner of a policy does not provide sufficient information for full compliance, or a checkbox an issuer could use to notify the IRS that a Form 1099-SB was being filed late because Form 1099-LS was received late). These requests were not included in the final regulations because Treasury and the IRS viewed the existing relief procedures, such as demonstrating reasonable cause under section 6724(a), to be adequate.⁸

Reporting for Gratuitous Transfers

As discussed later in this article, the final regulations did not adopt a recommended change to exclude gratuitous transfers from the definition of an RPS. However, the preamble included a lengthy discussion of the section 6050Y obligations with respect to gratuitous transfers, reaching the practical result that no reporting is required under any of the three components of section 6050Y if the only RPS that occurs with respect to a contract is a gratuitous transfer to a U.S. person:⁹

- The preamble notes that the acquirer in a gratuitous transfer is not required to perform the Form 1099-LS reporting because such reporting is only required with respect to an RPS payment recipient.¹⁰ The donor of the contract in a gratuitous transfer receives no payment and therefore is not an RPS payment recipient. Thus, there is no Form 1099-LS reporting and no RPS statement to be sent to the issuer.
- As a result, whether or not the gratuitous transfer meets the technical definition of an RPS, the issuer would not have been notified via an RPS statement, and thus no Form 1099-SB reporting is triggered.¹¹
- Further, since the issuer would not have been notified that an RPS had occurred, it would not be on notice that death benefits paid under the contract are reportable. The final regulations added an exception to relieve the payor from the Form 1099-R death benefit reporting obligation in this situation: Treas. Reg. section 1.6050Y-4(e)(3) provides that if a payor of reportable death benefits never received, and has no knowledge of any issuer having received, an RPS statement with respect to the interest in the contract, then the payor is not required to file or furnish a Form 1099-R under section 6050Y(c) and Treas. Reg. section 1.6050Y-4 for the death benefits paid. (It is implied that the beneficiary is responsible for properly reporting any taxable portion of the death benefits received, whether or not the payor is required to report under section 6050Y(c).)

Reporting for 1035 Exchanges

As will be discussed later in connection with changes to the regulations under section 101, the final regulations treat the issuance of a new contract in a 1035 exchange as an RPS if the owner of the new contract has no substantial family, business, or financial relationship with the insured.¹² The final regulations provide that the acquirer of the new contract in this situation must provide an RPS statement (*i.e.*, Form 1099-LS or substitute) to the insurance company issuing the new contract, although the acquirer would have no corresponding filing obligation with the IRS.¹³

It appears this could create a new and unexpected process whereby insurance companies may receive Form 1099-LS in connection with a new business case, when there has been no actual transfer of the newly issued contract. The insurance company is not required to file or furnish Form 1099-SB in this situation,¹⁴ as there has been no actual transfer, but would need to identify the policy on its administrative systems as having had an RPS, triggering the death benefit reporting requirement under section 6050Y(c) and Treas. Reg. section 1.6050Y-4.

Indemnity Reinsurance and the Definition of “Issuer”

As noted in our article in the October 2019 issue of *TAXING TIMES*, the proposed regulations contained a broad definition of “issuer,” explicitly including a reinsurance company that has reinsured on an indemnity basis all or a portion of the risks under a contract, apparently imposing reporting requirements on a party that does not administer the contract and would not generally have access to the required information to be able to report. Despite comments submitted on this topic, the definition is substantially unchanged in the final regulations.¹⁵ However, the preamble to the final regulations discusses the commenter’s concerns and outlines the provisions of the final regulations that, in practice, would limit the reporting obligations of an indemnity reinsurer.¹⁶

- As in the proposed regulations, the RPS statement is to be sent to the “6050Y(a) issuer,” which is the issuer responsible for administering the life insurance contract.¹⁷ Thus, indemnity reinsurers that do not administer the reinsured contracts should not receive a Form 1099-LS in the first place.
- As in the proposed regulations, the Form 1099-SB reporting is the responsibility of the “6050Y(b) issuer,” which is the issuer that receives an RPS statement or notice of a transfer to a foreign person. Normally this would be the insurer that actually administers the contract; however, if for some reason a reinsurer receives notice of a transfer to a foreign person, it can transfer the Form 1099-SB reporting responsibility back to the contract administrator by providing the notice to them, along with any available information necessary for such reporting.¹⁸
- In either case (RPS statement or notice of transfer to a foreign person), the proposed and final regulations both provide for unified reporting: a 6050Y(b) issuer will be deemed to have met its reporting obligations if the information to be reported with respect to that 6050Y(b) issuer is properly and timely reported by one or more other 6050Y(b) issuers or by a third-party information reporting contractor.¹⁹

Other Changes and Comments Affecting Reporting by Acquirers (Form 1099-LS)

In addition to the generally applicable changes already discussed, there were some minor changes made and several comments addressed that specifically relate to reporting by acquirers under section 6050Y(a) and Treas. Reg. section 1.6050Y-2.

The final regulations clarify the treatment of ancillary fees and other amounts paid in connection with the sale of a life insurance policy, generally aligning their treatment with the Form 1099-MISC reporting regime under sections 6041 and 6041A. Some commenters had requested the complete exclusion of

such ancillary amounts from the definition of an RPS payment, which Treasury declined to do because of the broad definition of “payment” in section 6050Y(d)(1)—*i.e.*, “the amount of cash and the fair market value of any consideration transferred” with respect to an RPS.²⁰ However, the final regulations do grant an exception for reporting RPS payments under section 6050Y(a) to a recipient other than the seller “if the [RPS] payment is reported by the acquirer under section 6041 or 6041A.”²¹ Additionally, the definition of RPS payment recipient was modified in the final regulations to exclude a person other than the seller who receives aggregate payments of less than \$600 with respect to the RPS;²² \$600 is the reporting threshold for payments to be reported on a Form 1099-MISC.

The preamble to the final regulations also addressed comments relating to certain transaction structures in the life settlement market. These comments included requests to exclude securities intermediaries and transitory holders of interests in a life insurance contract from the definition of an acquirer, since such holders are not the ultimate beneficial owner of the contract, as well as to exclude tertiary market transactions entirely from the definition of an RPS.²³ Treasury did not adopt the requested exemptions because the statutory definitions were broad and, in Treasury’s interpretation, do encompass these situations. However, with respect to the comments on acquirers, the final regulations clarified the allowance for unified reporting, under which an acquirer involved in a transaction having multiple acquirers, whether simultaneous or sequential, will be deemed to have met its reporting obligations if the information to be reported with respect to that acquirer is properly and timely reported by one or more other acquirers or by a third-party information reporting contractor.²⁴ From the insurance company’s perspective, it is worth noting that only a *direct* acquirer is required to furnish the RPS statement to the issuer of the contract;²⁵ however, in a series of prearranged transfers where multiple parties take legal title to the contract, it is conceivable that the issuer may receive multiple RPS statements with respect to the same overall transaction.

Other Changes and Comments Affecting Reporting by Issuers (Forms 1099-SB, 1099-R, and 1042-S)

There were also a number of clarifying changes made in the final regulations related to reporting by issuers and payers under sections 6050Y(b) and (c) and Treas. Reg. sections 1.6050Y-3 and 1.6050Y-4, in response to comments received on the proposed regulations.

With respect to the triggers for Form 1099-SB reporting, under the final regulations, in order to constitute “notice of a transfer to a foreign person,” the notice received by a 6050Y(b) issuer must include foreign indicia.²⁶ Thus, Form 1099-SB reporting is triggered if the issuer receives “any notice of a transfer of title

to, possession of, or legal ownership of a life insurance contract ... that includes foreign indicia ... unless the 6050Y(b) issuer knows that no transfer of the contract has occurred or knows that the transferee is a United States person.”²⁷

With respect to Form 1099-R reporting, the final regulations require the form to include the “gross amount of *reportable death benefits paid* to the reportable death benefits payment recipient during the taxable year,” rather than the “gross amount of *payments made* ...” in the proposed regulations.²⁸ This clarification should prevent inappropriate duplicate reporting of other types of payments made to the recipient (*e.g.*, interest paid on a delayed death claim).

Additionally, the final regulations clarify that the requirement to file a corrected Form 1099-R after rescission of an RPS is triggered by “recovering any portion of the reportable death benefits payment from the reportable death benefits payment recipient as a result of the rescission of the reportable policy sale,” rather than simply by the receipt of notice of rescission.²⁹

The final regulations also clarify the potential overlap between filing Form 1099-R pursuant to section 6050Y(c) and filing Form 1042-S pursuant to other requirements to report U.S.-source income paid to a foreign person. The final regulations remove the specific discussion of Form W-8ECI and replace it with more general references to due diligence requirements that may apply to a payor that relies on the exception relating to foreign beneficial owners.³⁰ As stated in the preamble: “As a result, the final regulations do not require reportable death benefits paid to a foreign person that must be reported on Form 1042-S to also be reported on Form 1099-R.”³¹

TRANSFER-FOR-VALUE RULE

As detailed in our earlier article, the proposed regulations address the meaning of a transfer-for-value under section 101(a)(2), the application of the Carry-Over Basis and Related-Party Transfer Exceptions, and the scope of the term “reportable policy sale” (*i.e.*, RPS). In the discussion that follows, we focus on changes to the proposed regulations with respect to these elements of the transfer-for-value rule. Our earlier article should be referenced for a discussion of aspects of the regulatory guidance on the transfer-for-value rule that were not altered.

Effective Date for Regulations Under Section 101

The final regulations under section 101 provide different effective date rules with respect to the applicability of those regulations as relevant to tax reporting under section 6050Y and with respect to the applicability of those rules for purposes of ascertaining the tax treatment of death benefits under section 101. In the former regard, for purposes of determining whether there is an RPS or payment of reportable death benefits, Treas.



Reg. section 1.101-6(b) provides that the new regulations under section 101 apply to RPSs made after Dec. 31, 2018, and to reportable death benefits paid after Dec. 31, 2018. These effective date rules mirror those otherwise applicable for purposes of the final regulations under section 6050Y.

Treas. Reg. section 1.101-6(b) goes on to state, however, that for other purposes, including for purposes of determining the portion of death benefits that are excludable from income under section 101, the new regulations under Treas. Reg. section 1.101-1(b)-(g) “apply to amounts paid by reason of the death of the insured under a life insurance contract, or interest therein, transferred after October 31, 2019.” Since the TCJA’s amendment of the transfer-for-value rules of sections 101(a)(2) and (3) is effective for transfers after Dec. 31, 2017,³² the final regulations do not apply to transfers after Dec. 31, 2017, and on or before Oct. 31, 2019. Thus, the statute without regard to the final regulations appears to govern the tax treatment under the transfer-for-value rule of those transactions, which had raised concerns among practitioners with respect to indirect acquisitions that occurred in that time period (*e.g.*, an ordinary-course-of-business acquisition of a corporation or bank that

held life insurance). Treas. Reg. 1.101-6(b) further provides, however, that pursuant to section 7805(b)(7), which authorizes Treasury to allow use of regulations prior to their effective date, a taxpayer may apply the new final regulations of Treas. Reg. section 1.101-1(b)-(g) “in their entirety, with respect to all amounts paid by reason of the death of the insured under a life insurance contract or interest therein, transferred after December 31, 2017, and on or before October 31, 2019.”

Transfers to the Insured

The final regulations include a number of changes to the proposed regulations for situations where a policy is transferred to the insured, which is relevant to the Related-Party Transfer Exception. The final regulations’ treatment differs depending on whether the policy was previously transferred in an RPS.

Where a policy previously was transferred for value but that transfer was not an RPS, the final regulations provide for a “fresh start” if the policy is gratuitously transferred back to the insured, so that the transfer-for-value rules do not apply.³³ This is illustrated by Treas. Reg. section 1.101-1(g)(2), Example 2, which involves a policy originally owned by and covering A, which is transferred for full fair market value (“FMV”) to A’s child B but then is later gratuitously transferred by B back to A. Although the first transfer from A to B was for value, it was not an RPS due to the substantial family relationship between A and B. Since the second transfer is back to A (the insured), the Related-Party Transfer Exception to the transfer-for-value rule is available and is not tainted by the prior transfer-for-value that was not an RPS.

Where a policy previously was transferred for value and that transfer was an RPS, the final regulations provide for a more limited “fresh start.” In particular, for a policy that is transferred back to the insured where there was a prior RPS of the policy, fresh start treatment applies only to the extent the insured pays FMV for the policy and does not subsequently transfer the policy for valuable consideration or in an RPS.³⁴ This is illustrated by Treas. Reg. section 1.101-1(g)(6), Example 6, which involves a policy originally owned by and covering A, which is transferred to C in an RPS for full FMV but then is later transferred by C back to A for full FMV. Due to the subsequent transfer of the policy to A (the insured) for FMV, A’s estate will be able to exclude the entire death benefit proceeds from income, even though there was a prior transfer for value that was an RPS.

If instead A had purchased the policy for less than full FMV from C, the final regulations treat the transaction as a bargain sale, *i.e.*, as in part a transfer for valuable consideration and in part gratuitous. For the portion of the policy for which FMV is paid by the insured, fresh start treatment as just described applies, but for the gratuitously transferred portion of the

policy to the insured Treas. Reg. section 1.101-1(b)(2) limits the amount of the exclusion to the sum of the proceeds attributable to the gratuitously transferred interest that would have been excludable by the transferor if the transfer had not occurred and the premiums and other amounts subsequently paid by the transferee.³⁵ This is illustrated by Treas. Reg. section 1.101-1(g)(7), Example 7, which is a new example that has been added to the regulations.

Treas. Reg. section 1.101-1(g)(8), Example 8, offers a further example involving a policy that is initially transferred back to the insured A for full FMV (as in Example 6 above), but then A transfers 50 percent of the policy to A’s child, B, and sells the other 50 percent interest to unrelated party E for FMV in an RPS. Reflecting the fresh start provided when the policy was purchased by the insured, A, for full FMV, and also the regulations’ treatment of gratuitous transfers of policies, the excludable portion of the death benefit under B’s policy is limited under Treas. Reg. section 1.101-1(b)(2)(i) to the “sum of the amount of the proceeds attributable to the gratuitously transferred interest that would have been excludable by the transferor if the transfer had not occurred and the premiums and other amounts subsequently paid by the transferee with respect to the interest.” Since the exclusion would not have been limited to A due to the fresh start, it is not limited to B, who gratuitously received the policy from A. This treatment applies regardless of whether the transfer to B is an RPS. (Here, it would not be an RPS due to the substantial family relationship between A and B.) In contrast, the transfer to E for full FMV is an RPS, and the transfer-for-value rule will limit the excludable death benefit proceeds to the consideration E paid for the policy, including subsequently paid premiums. New example Treas. Reg. section 1.101-1(g)(9), Example 9, continues Example 8 but assumes that the policy is transferred for FMV to a family partnership.

Reportable Policy Sales—in General

A number of changes were made to the regulatory discussion of the meaning of an RPS—generally discussed in Treas. Reg. section 1.101-1(c)—in response to comments. For example, the final regulations include two new exceptions to the definition of an RPS. One exception is for “[t]he acquisition of a life insurance contract by an insurance company that issues a life insurance contract in an exchange pursuant to section 1035.”³⁶ Another exception is provided for:

The acquisition of a life insurance contract by a policyholder in an exchange pursuant to section 1035, if the policyholder has a substantial family, business, or financial relationship with the insured, apart from its interest in the life insurance contract, at the time of the exchange.³⁷

The first of these exceptions was needed because, otherwise, routine section 1035 transactions not involving any transfer for value of a policy might be subjected to the reporting requirements of section 6050Y. The second exception to RPS treatment—excluding acquisitions of the new policy received by a policyholder in a section 1035 exchange in certain circumstances—is needed but seems too narrow in that it is limited by the condition that there exist a substantial family, business, or financial relationship at the time of the exchange. (We offer further commentary about this point later in this article in connection with the regulations’ definition of a “transfer of an interest in a life insurance contract.”)

In other comments submitted on the proposed regulations, Treasury was asked to exclude gratuitous transfers from the definition of an RPS. This request was not adopted. Reflecting this conclusion, Treas. Reg. section 1.101-1(b)(2)(i) refers to a transfer that “is gratuitous, including a reportable policy sale that is not for valuable consideration.” Thus, the definition of an RPS can include some transfers that are not “sales” in the ordinary sense.

Another change relating to the scope of the RPS definition pertains to indirect acquisitions of an interest in a policy. In particular, in response to comments, an exception to the RPS definition was modified to exclude indirect acquisitions of an interest in a life insurance policy if an entity such as a partnership or trust in which an ownership interest is being acquired “directly or indirectly holds the interest in the life insurance policy and acquired that interest before January 1, 2019, or acquired that interest in a reportable policy sale reported in compliance with section 6050Y(a) and § 1.6050Y-2.”³⁸ Comments submitted on the proposed regulations also requested that an alternative provision of the indirect acquisition exception be expanded by deleting a requirement that the entity holding the direct or indirect interest in the policy have no more than 50 percent of the gross value of its assets invested in life insurance immediately before the indirect acquisition. Treasury did not adopt this request.³⁹

RPSs: Substantial Relationship Exceptions to RPS Treatment

Under the proposed regulations, a substantial family relationship was deemed to exist between a partnership, trust, or other entity if all of the beneficial owners of the entity have a substantial family relationship with the insured.⁴⁰ The final regulations expand this rule to include situations where every beneficial owner has a substantial family, business, or financial relationship with the insured.⁴¹ Thus, for example, if one beneficial owner has a substantial financial relationship with the insured and all other beneficial owners have a substantial family relationship with the insured, the substantial relationship exception to RPS

treatment will be satisfied. The final regulations also allow the IRS through the Internal Revenue Bulletin to describe situations involving a charitable organization that will be treated as a substantial financial relationship beyond those set forth in the final regulations.

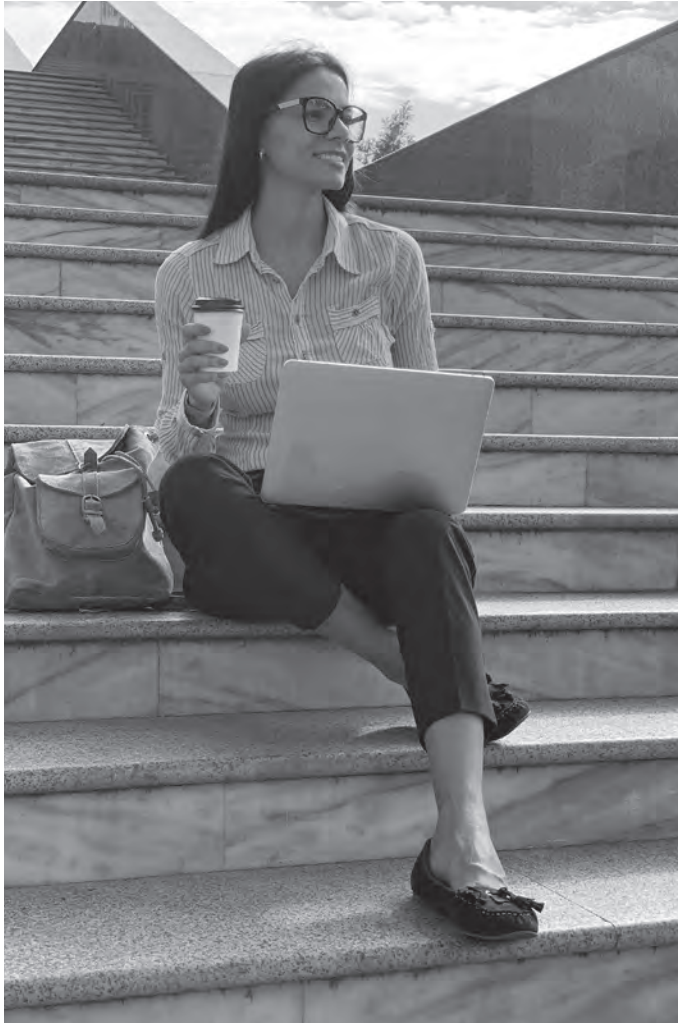
The final regulations also modify the definition of substantial financial relationship. Under the proposed regulations, one situation in which such a relationship existed is where the acquirer “maintains the life insurance contract on the life of the insured to provide funds to purchase assets or satisfy liabilities following the death of the insured.”⁴² The final regulations clarify that the policy must be maintained “to provide funds to purchase assets of or to satisfy liabilities *of the insured or the insured’s estate, heirs, legatees, or other successors in interest, or to satisfy other liabilities arising upon or by reason of the death of the insured.*”⁴³ In the context of bank-owned life insurance, comments had requested clarification that certain bank-owned life insurance pooling arrangements of policies were within the scope of the rule. Treasury did not adopt the requested clarification, noting that a bank in such pooling arrangements did not have a substantial financial relationship with respect to insureds under policies contributed to the pooling arrangement by other banks.

Transfers of an Interest in a Life Insurance Contract

The final regulations retain the proposed regulations’ definition of a “transfer of an interest in a life insurance contract.”⁴⁴ The final regulations thus provide that such a transfer does not include “[t]he revocable designation of a beneficiary of the policy proceeds (until the designation becomes irrevocable other than by reason of the death of the insured).”⁴⁵ Similarly, the final regulations provide that a transfer of an interest in a life insurance contract does not include “the issuance of a life insurance contract to a policyholder, other than the issuance of a policy in an exchange pursuant to section 1035.”⁴⁶

The reference to section 1035 exchanges in the definition of a “transfer of an interest in a life insurance contract” appears to indicate that a policy received by a policyholder in a section 1035 exchange would be characterized as having been transferred, even though the term “transfer” seemingly connotes that property preexisted, which was capable of being transferred. The preamble to the final regulations reflects this viewpoint.⁴⁷ For a newly issued life insurance policy, however, that policy did not exist prior to its issuance, and thus it is difficult to see how it could be transferred. In this regard, it seems that the “issuance” of a policy should be distinguishable from a “transfer” of a policy. Regarding the rationale for the treatment applied by the final regulations, the preamble to the final regulations explains:

The concern prompting the reference in § 1.101-1(e)(2) of the proposed regulations to section 1035 exchanges



related to the possibility that a policy transferred in a reportable policy sale subsequently could be exchanged for a new policy in an exchange pursuant to section 1035 and that, absent the reference in § 1.101-1(e)(2), the death benefits paid under the new policy might not be reported under section 6050Y(c).⁴⁸

The regulations seemingly could have provided for a carryover of tax attributes to prevent cleansing of attributes associated with the policy given in the exchange, such as whether that prior policy had been acquired in a transfer for value, but the treatment accorded under the final regulations appears to be broader, applying even if there has been no prior transfer for value. In such a circumstance, the tax policy underlying the transfer-for-value rule seems entirely absent, and the tax policy underlying section 1035 arguably is undermined. The exceptions to application of the transfer-for-value rule contained in section 101(a)(2)(A) and (B), and the exceptions to RPS treatment, often would ameliorate this concern, but not in all cases.

The final regulations also clarify that an “acquisition of an interest in a life insurance contract” can be of a legal or beneficial interest.⁴⁹ Treas. Reg. section 1.101-1(g)(16), Example 16, illustrates a situation in which two persons acquire an interest in a contract, one the legal title holder and the other a beneficial owner. Both the transfer of legal title to the nominee and the transfer of economic benefits to the beneficial owner are treated as RPSs.

Indirect Acquisitions of an Interest in a Life Insurance Contract

The definition of RPS includes certain direct and indirect acquisitions of interests in life insurance contracts. Comments submitted on the proposed regulations requested expansion of the exceptions to RPS treatment to encompass certain tax-free reorganizations that were not encompassed by exceptions included in the proposed regulations. This request focused on the scope of Treas. Reg. section 1.101-1(e)(3)(ii), which defines “indirect acquisitions of an interest in a life insurance contract” and excludes from the scope of this term acquisitions of an interest in a C corporation where 50 percent or less of the gross value of the assets of the C corporation consisted of life insurance contracts immediately before the indirect acquisition. The comments expressed concern that the exception did not extend to certain tax-free reorganizations where an interest in a life insurance contract is directly acquired, including where the separate corporate existence of the target terminates. Treasury did not adopt this request to extend the exception to all tax-free reorganizations.

Similar comments were offered in connection with the special rule of Treas. Reg. section 1.101-1(c)(4)(i), which provides for purposes of the RPS definition that an acquirer of an indirect interest in a policy is deemed to have a substantial financial or business relationship with the insured if the direct holder of the interest has such a relationship with the insured both before and after the acquirer acquires its interest. Comments noted that this rule could apply for certain reorganization transactions but not others, *e.g.*, where the insured’s employment terminates as a result of an acquisition or merger or where the person that previously held an indirect interest acquires a direct interest. Treasury did not adopt the request to extend the rule to these other situations, although Treasury noted that other exceptions to RPS treatment may apply depending on the facts.

REVISION REGARDING SCOPE OF SECTION 101

Prior to the effective date of Treasury Decision 9879, Treas. Reg. section 1.101-1(a)(1) provided that death benefits that were within the scope of section 101 included “[d]eath benefit payments having the characteristics of life insurance proceeds payable by reason of death under contracts, such as workmen’s compensation insurance contracts, endowment contracts, or accident and health insurance contracts.” The final regulations amended this provision so that it continues to apply only to

contracts issued on or before Dec. 31, 1984. Presumably, for later issued contracts, it is necessary that the contract, or portion of a contract, constitute life insurance under applicable law within the meaning of section 7702(a) and that such contract or portion of a contract otherwise satisfy the requirements of section 7702 in order for death benefits to be within the scope of section 101. The regulations do not discuss if or in what circumstances this might be the case in the context of health insurance policies.⁵⁰

CONCLUDING THOUGHTS

The Treasury and IRS are to be commended for the thoughtful manner in which they have provided guidance on the TCJA's new rules for transfers for value and related reporting. The final regulations generally were responsive and appropriate in light of comments submitted and were guided by the purpose underlying the TCJA changes. Some further changes or other guidance, however, likely will be needed on a number of points, and no doubt additional questions will arise as insurers and other affected parties implement the new rules. ■

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ENDNOTES

- 1 Except as otherwise noted, references to "section" are to sections of the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations thereunder.
- 2 See also 84 Fed. Reg. 58460 (Oct. 31, 2019).
- 3 Pub. L. No. 115-97, title I, § 13522.
- 4 See also Treas. Reg. section 1.101-1(c).
- 5 Treas. Reg. section 1.6050Y-1(b). See also 84 Fed. Reg. 58461 (Oct. 31, 2019).
- 6 See 84 Fed. Reg. 58461 (Oct. 31, 2019) and Treas. Reg. section 1.101-6(b).
- 7 In Notice 2018-41, 2018-20 I.R.B. 584, the IRS expressed its intention of allowing additional time after the date of publication of final regulations for filing returns and furnishing statements required by section 6050Y with respect to RPSs and reportable death benefits occurring after Dec. 31, 2017, and before the date final regulations are published in the Federal Register. A similar intention is reflected by Prop. Reg. section 1.6050Y-1(b).
- 8 See 84 Fed. Reg. 58475, 58477, 58461 (Oct. 31, 2019).
- 9 84 Fed. Reg. 58475-58476 (Oct. 31, 2019).

- 10 Treas. Reg. section 1.6050Y-2(a) and (d).
- 11 See Treas. Reg. section 1.6050Y-3(a). Note that this discussion implicitly assumed that the acquirer in the gratuitous transfer is a U.S. person.
- 12 Treas. Reg. section 1.101-1(c)(2)(v).
- 13 Treas. Reg. section 1.6050Y-2(f)(3).
- 14 Treas. Reg. section 1.6050Y-3(f)(3).
- 15 Treas. Reg. section 1.6050Y-1(a)(8)(i).
- 16 84 Fed. Reg. 58471 (Oct. 31, 2019).
- 17 Treas. Reg. section 1.6050Y-1(a)(8)(ii).
- 18 Treas. Reg. section 1.6050Y-1(a)(8)(iii)(B). See also 84 Fed. Reg. 58471-58472 (Oct. 31, 2019).
- 19 Treas. Reg. sections 1.6050Y-3(b) and 1.6050Y-3(d)(3).
- 20 See also Treas. Reg. section 1.6050Y-1(a)(15), clarifying in the final regulations that the "consideration" must be reducible to a money value.
- 21 Treas. Reg. section 1.6050Y-2(f)(2).
- 22 Treas. Reg. section 1.6050Y-1(a)(16)(ii).
- 23 84 Fed. Reg. 58473-58474 (Oct. 31, 2019).
- 24 Treas. Reg. sections 1.6050Y-2(b) and 1.6050Y-2(d)(3). The proposed regulations allowed unified reporting only for a series of prearranged transfers; the final regulations added simultaneous transfers of different interests in a single life insurance contract.
- 25 Treas. Reg. section 1.6050Y-2(d)(2)(i)(B).
- 26 Treas. Reg. section 1.6050Y-1(a)(10).
- 27 *Id.*
- 28 Treas. Reg. section 1.6050Y-4(a)(4) (emphasis added).
- 29 Treas. Reg. section 1.6050Y-4(d).
- 30 Treas. Reg. section 1.6050Y-4(e)(1). Note that the discussion of Form W-8ECI is retained in the provisions relating to Form 1099-SB reporting; see Treas. Reg. section 1.6050Y-3(f)(1).
- 31 84 Fed. Reg. 58477 (Oct. 31, 2019).
- 32 TCJA section 13522(c).
- 33 Treas. Reg. section 1.101-1(b)(2)(i).
- 34 Treas. Reg. section 1.101-1(b)(1)(iii)(B)(3).
- 35 Treas. Reg. section 1.101-1(b)(2)(i) and (iii).
- 36 Treas. Reg. section 1.101-1(c)(2)(iv).
- 37 Treas. Reg. section 1.101-1(c)(2)(v).
- 38 Treas. Reg. section 1.101-1(c)(2)(iii)(A).
- 39 See Treas. Reg. section 1.101-1(c)(2)(iii)(B).
- 40 Prop. Reg. section 1.101-1(d)(1).
- 41 Treas. Reg. section 1.101-1(d)(4)(iii).
- 42 Prop. Reg. section 1.101-1(d)(3)(ii).
- 43 Treas. Reg. section 1.101-1(d)(3)(ii) (emphasis added).
- 44 Treas. Reg. section 1.101-1(e)(2).
- 45 *Id.*
- 46 *Id.*
- 47 84 Fed. Reg. 58465-58466 (Oct. 31, 2019).
- 48 84 Fed. Reg. 58465 (Oct. 31, 2019).
- 49 Treas. Reg. section 1.101-1(e)(3).
- 50 The legislative history of section 7702 discusses contracts that in part are treated as life insurance and in part are treated as annuity contracts under state law. See, e.g., S. Prt. No. 98-169, vol. I, at 572 (1984).