



TRUMP TAX REFORM



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Life Insurance Planning After Tax Reform

Direct and indirect changes create new and interesting life insurance planning opportunities.

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The Tax Cuts and Jobs Act was signed into law by President Trump on December 22, 2017. The Act brings direct changes to the tax treatment of insurance and significant indirect changes to planning with life insurance. These changes present new and

interesting life insurance planning opportunities. Here, we detail the direct and indirect changes. A future article will cover the insurance planning opportunities.

Direct Changes

The Act imposes reporting requirements in the case of the purchase of an existing life insurance contract in a reportable policy sale and imposes reporting requirements on the payor in the case of the payment of reportable death benefits. These reporting requirements apply to every person who acquires a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale during the taxable year. A reportable policy sale is 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 the life insurance contract). An indirect acquisition includes the acquisition of an interest in a partnership, trust or other entity that holds an interest in the life insurance contract.

Under the reporting requirement, the buyer reports information about the purchase to the Internal Revenue Service, the insurance company that issued the contract and the seller. The information reported by the buyer about the purchase is: (1) the buyer's name, address and taxpayer identification number; (2) the name, address and TIN of each recipient of payment in the reportable policy sale; (3) the date of the sale; (4) the name of the issuer; and (5) the amount of each payment. On receipt of a report described above, or on any notice of the transfer of a life insurance contract to a foreign person, the issuer is required to report to the IRS and to the seller: (1) the name, address and TIN of the seller or the transferor to a foreign person; (2) the basis of the contract (that is, the investment in the contract within the meaning of Internal Revenue Code Section 72(e)(6)); and (3) the policy number of the contract.

When a reportable death benefit is paid under a life insurance contract, the payor insurance company is required to report information about the payment to the IRS and to the payee. Under this reporting requirement, the payor reports: (1) the name, address and TIN of the person making the payment; (2) the name, address and TIN

of each recipient of a payment; (3) the date of each such payment; (4) the gross amount of the payment; and (5) the payor's estimate of the buyer's basis in the contract. A reportable death benefit means an amount paid by reason of the death of the insured under a life insurance contract that's been transferred in a reportable policy sale. The Act also provides that the exceptions to the transfer for value rules don't apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. Thus, some portion of the death benefit ultimately payable under such a contract may be includible in income.

The Act also changes the calculation of tax basis in life insurance contracts. In Revenue Ruling 2009-13, the IRS had ruled that income recognized under IRC Section 72(e) on surrender to the life insurance company of a life insurance contract with cash value is ordinary income. In the case of sale of a cash value life insurance contract, the IRS ruled that the insured's (seller's) basis is reduced by the "cost of insurance" and the gain on sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered (the "inside buildup") and any excess is long-term capital gain.

The Act overrules the above and provides that in determining the basis of a life insurance or annuity contract, no adjustment is made for mortality, expense or other reasonable charges incurred under the contract, known as "cost of insurance." Gain on the sale of a term life insurance contract, without cash surrender value, is long-term capital gains under the ruling. This change specifically reverses the position of the IRS in Rev. Rul. 2009-13 that on sale of a cash value life insurance contract, the insured's (seller's) basis is reduced by the cost of insurance.

Indirect Changes

The doubling of the estate tax exemption will eliminate the need for most clients to purchase or maintain existing life insurance policies to pay a federal estate tax. Practitioners should caution clients seeking to cancel existing coverage about the risks of a future administration changing the estate tax rules, yet again. In some instances, it may also be feasible to repurpose existing life insurance and irrevocable

life insurance trusts to meet new needs, for example, liquidity, premature death (mortality risk) in a spousal lifetime access trust, or SLAT, but likely only in grantor SLATs, not the new variant of non-grantor SLATs that may be used by some, and so forth.

For taxpayers realizing a reduction in marginal income tax costs, the use of life insurance as a tax-favored envelope may lessen. Other taxpayers, perhaps high-income earners (especially professionals characterized as Specified Service Businesses who can't avail themselves of the new IRC Section 199A 20 percent pass-through entity deduction) in high tax states, might find that the tax deferral features of permanent life insurance are enhanced by the Act.

Split-dollar life insurance transactions need to be unwound at some point in time as an exit strategy. For taxpayers with moderate wealth relative to the new exemption amounts, using the new gift tax exemption to gift assets to a trust involved in a split-dollar plan may facilitate that trust paying off a split-dollar loan and unwinding a transaction that might no longer be needed.

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