2017 TAX CUTS AND JOBS ACT

Impact on Life Settlements

ashar group | LIFE SETTLEMENTS | POLICY APPRAISALS

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Favorable Income Tax Treatment of a Life Settlement

It's an issue of fairness that the life settlement community has been fighting for almost a decade. It started with IRS Revenue Ruling 2009-13 enacted in 2009. The ruling outlined tax treatment for sale or surrender of a life insurance policy. The problem created by the 2009 revenue ruling was that tax treatment for policy sale was treated differently than the tax treatment for a policy surrender which hampered policy sales and made it difficult to calculate taxes for life settlements. The 2009-13 tax ruling imposed a formula on life settlements for calculating basis that required removing the cost of insurance (COI) from the policy tax basis. COI is a calculation that has to be provided by the insurance carriers and is often extremely difficult, if not impossible, to get. COI did not have to be removed from the policy tax basis for policies that were surrendered back to the carrier. The Tax Cuts and Jobs Act (TCJA) eliminates the requirement to remove COI from the cost basis of a policy sale thereby putting policy sale on a level playing field with policy surrender. Also, the new tax law is retroactive for policy sales dating back to August 25, 2009.

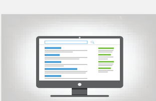
What does this really mean for clients who sell their life insurance policy on the life settlement market? It means significant tax savings because now the premiums paid, which includes COI, equals cost basis.

Increased Estate Tax Exemption

TCJA increases the estate tax exemption to $11.2 million per individual and $22.4 million per married couple. Since life insurance has long been the cornerstone of estate and tax planning for HNW individuals, insurance professionals and fiduciaries nationwide have clients that are trying to decide if they need to keep the insurance that had been put into place for estate protection. This increased exemption impacts only a segment of high net worth (HNW) clients. It follows on the heels of the 2012 American Taxpayer Relief Act (AFTR), which also affected policy owners with sizeable estates by increasing the estate tax exemption from the previous level. So, with AFTR in 2012 and TCJA in 2017, the trend seems to be in favor of reducing estate taxes. However, the TCJA sunsets on December 31st, 2025.

We saw an uptick in policy owners wanting to sell all or part of their permanent or term life insurance when AFTR was enacted in 2012 and we are seeing the same increase in life settlement activity as a result of TCJA. However, the question of whether or not a HNW client still needs the same level of life insurance after the exemption increase is one for planners and fiduciaries to help figure out. We highly recommend that planners and fiduciaries get a secondary market valuation (SMV®) to help their clients make that decision.

Additional Resources:



Find out if your client qualifies for a life settlement using Ashar's 7-question policy value quiz.

Real-life stories from real client experiences.