



Be Careful What You Wish For
Developments in Life Insurance Tax

November 9, 2020

Panel

Panelists

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Agenda

- Panel Overview
- TCJA Changes to Section 807
- Section 807 Regulations
- Published Guidance and Campaigns
- TCJA Changes to Life Settlement Transactions

TCJA Changes to Section 807

Section 807 Developments

- December 22, 2017 – TCJA amended section 807
 - Effective for taxable years beginning after December 31, 2017
- April 2, 2020 – Proposed Regulations published
 - No public hearing requested or held
- September 10, 2020 – Final Regulations released
 - Published October 13, 2020
- September 10, 2020 – Rev. Rul. 2020-19 released
 - Updated guidance for identifying changes in basis
- September 14, 2020 – LB&I Campaigns announced

Section 807(d)

Section 807(d) - Computation of life insurance reserves

- General rule is that amount of reserve is greater of
 - net surrender value (NSV) or
 - 92.81% of reserve determined using the tax reserve method (CRVM, CARVM, other) as of the reserve determination date, not the date of contract issuance
- Special rule for Variable Contracts
 - Greater of NSV or separate account portion of reserve, PLUS
 - 92.81% of the remainder of the amount determined using the tax reserve method (CRVM, CARVM, other) as of the reserve determination date, not the date of contract issuance
- TCJA did not amend
 - Life reserves continue to be bounded by statutory reserve cap and NSV floor
 - Exclusion of deficiency reserves from life insurance reserves (section 816(h))
 - No amendment to section 811(a)

Section 807(d)

Additional Background

*“Consistent with the purpose of the provision to accommodate the NAIC-prescribed **principle-based reserve methodology** and to provide for a tax reserve amount that is simpler, more transparent, and easier to compute than under prior law, the provision provides for a percentage reduction to address the inconsistency of insurance regulatory accounting with accurate measurement of income for Federal income tax purposes. Under NAIC-prescribed principle-based reserve methodology in effect [December 22, 2017], principle-based reserves for any contract do not include any **asset adequacy reserve** component. Therefore, no asset adequacy related reduction to the NAIC-prescribed PBR reserves as then in effect is necessary or required before applying the percentage reduction in computing tax reserves.”*

TCJA Blue Book at page 235 (emphasis added)

Section 807(d)

New Questions

- What changes, if any, must be made to statutory reserves reported on the NAIC annual statement for NAIC reserves for U.S. federal income tax purposes?
 - What constitutes CRVM or CARVM?
- What are asset adequacy reserves?
 - Not referred to or defined in Subchapter L
 - Referred to but not defined in House Report or JCT Blue Book

Section 807(f)

Section 807(f) - Changes in basis of computing reserves

- If basis as of close of taxable year differs from basis as of close of the preceding year, then so much of the difference between the EOY reserve on the new basis and the EOY reserve on the old basis as is attributable to contracts issued before the taxable year “**shall be taken into account under section 481 as adjustments attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary.**”

Section 807(f)

Additional Background

Section 807(f) - Changes in basis of computing reserves

“The prior law 10-year spread rule to account for [a change in basis] is repealed. Thus, income or loss resulting from a change in method of computing reserves is taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

Consistent with IRS procedures, a company that makes a change in method of computing life insurance company reserves is required to comply with procedures for automatic method changes and is required to report and file such statements and other information as the Secretary requires under these procedures.”

TCJA Blue Book at page 228 (emphasis added)

Section 807(f)

New Questions

- Is a change a basis of computing reserves treated as a change in method of accounting? Or did TCJA amend only the spread period to align with section 481 spread periods?
- What constitutes a change in basis?

Section 807(e)(6)

Section 807(e)(6) – Reserve reporting

- “The Secretary shall require reporting (at such time and in such manner as the Secretary shall prescribe) with respect to the opening balance and the closing balance of reserves and with respect to the method of computing reserves for purposes of determining income.”

Section 807(e)(6)

New Questions

Section 807(e)(6) – Reserve reporting

- Will the IRS consult with insurance industry before promulgating new reporting requirements?
- How will the IRS balance the reporting burden on insurance companies with the utility to the IRS examinations?

Section 807 Regulations

Proposed and Final Regulations

- Computation of life insurance reserves – Section 1.807-1
- Changes in basis for computing reserves – Section 1.807-4
- Reserve reporting for tax purposes – section 1.807-3
- Other Issues

Proposed and Final Regulations

Asset Adequacy Reserves

- What are their characteristics for statutory purposes?
 - Determined under Part 30 of the Valuation Manual (VM-30)
 - Cash Flow Testing
 - Held in Addition to CRVM, CARVM reserves
 - Generally determined for the company, not for particular policies or policy liabilities
- Why are they not deductible for tax purposes?
 - Not part of the Tax Reserve Method under Section 807(d)
 - Not held to liquidate unmatured claims under contracts
 - Tax authorities compare to solvency reserves

Proposed and Final Regulations

Asset Adequacy Reserves: Section 1.807-1(b)

(b) No Asset Adequacy reserve. The life insurance reserve determined under section 807(d)(1) does not include any asset adequacy reserve.

(1) An asset adequacy reserve is—

(i) Any reserve that is established as an additional reserve based upon an analysis of the adequacy of reserves that otherwise would be established in accordance with the requirements set forth in the [VM], such as the CRVM or CARVM as applicable, or

(ii) Any similar reserve.

(2) In determining whether a reserve is a life insurance reserve, the label placed on such reserve is not determinative, provided, however, any reserve or portion of a reserve that would have been established pursuant to an asset adequacy analysis required by [VM-30] as it existed on December 22, 2017 ... is an asset adequacy reserve.

Proposed and Final Regulations

Asset Adequacy Reserves: Section 1.807-1

- The regulations apply to taxable years beginning after date of publication in the Federal Register, generally 2021.
- Proposed regulations had defined AAR according to what are AAR “includes,” rather than what AAR “is.” IRS sharpened the definition in response to comments.
- Final regulations declined to reference VM-30 as of the reserve valuation date.
- Questions remain
 - What is a “similar reserve”?
 - How does the regulation apply after NAIC makes changes to VM-30?

Proposed and Final Regulations

Changes in basis for computing reserves

- Amendment to section 807(f) requires accounting for section 807(f) adjustment under the general rules that apply to automatic changes in accounting method under section 481(a)
- In 2019, IRS set forth the terms and conditions for changes in basis under section 807(f), including a requirement that an abbreviated Form 3115 be filed
 - Four-year spread for positive adjustments, 1-year recognition for negative
 - Audit protection

Proposed and Final Regulations

Changes in basis for computing reserves

- Issues addressed in proposed and final regulations
 - Relationship between section 446 and Subchapter L

“Except in extraordinary circumstances, section 446(b) does not affect the requirement that a life insurance company compute its reserves for Federal income tax purposes as required by Subchapter L. Similar, Subchapter L does not affect the requirements under section 446(e) that an insurance company secure the consent of the Commissioner before changing its basis of computing reserves.”
 - Examples and need for additional guidance, see Rev. Rul. 2020-19
 - Automatic consent procedures, netting of adjustments
 - Obsoleting of prior revenue rulings and notice

Proposed and Final Regulations

Reserve reporting for tax purposes – Section 1.807-3

(a) Reserve reporting. A life insurance company subject to tax under Section 801 is required to make a return on Form 1120-L The Internal Revenue Service may require reporting with respect to the opening balance and closing balance of items described in section 807(c) and with respect to the method of computing such items for purposes of determining income. Such reporting may provide for the manner in which separate account items are reported.

Proposed and Final Regulations

Reserve reporting for tax purposes – Section 1.807-3

- Final regulations thus “kicked the can down the road” as to time and manner of reporting
- Concerns remain as to how much burden will be imposed, and how meaningful the reporting will be
- “The IRS understands the importance of obtaining the life insurance industry’s input before changing the reporting requirements. ... [T]he IRS expects to consult with the life insurance industry before making any changes to reporting requirements. Further ... any future changes to tax return form requirements ... would be subject to burden analysis and public notice and comment under the Paperwork Reduction Act.”

Proposed and Final Regulations

Other Issues –

- Definition of life insurance reserves permits other factors, GPV
- Electronic filing of tax returns
- Electronic attachment of annual statements
- Paperwork Reduction Act and other procedural matters
- Issues not addressed
- Guidance that is modified or obsoleted

Proposed and Final Regulations

Issues not addressed – Foreign-issued, noncompliant contracts

- Proposed regulations requested comments on reserve treatment of foreign issued contracts that do not satisfy annuity distribution requirements of section 72(s), diversification requirements of section 817(h), or life insurance definitional requirements of section 7702
- Comments requested those contracts be accounted for by an issuer or reinsurer consistent with accounting for compliant contracts, subject to guardrails
- Final regulations decline to address these issues as they “are complex and require further study”

Proposed and Final Regulations

Regulations amended or obsolete

- 1.338-11 1.809-2 1.848-1
- 1.381(c)(22)-1 1.809-5 1.6012-2
- 1.801-2 1.810-3
- 1.801-5 1.816-1
- 1.801-7 1.817A-0, -1
- 1.801-8(e) 1.818-2
- 1.806-4 1.818-4
- Most are pure conforming changes, or administrative interpretations of Code provisions that no longer are relevant.

Proposed and Final Regulations

Other guidance obsoleted or revoked

- Rev. Rul. 2002-6
 - Rev. Rul. 94-74
 - Rev. Rul. 80-117
 - Rev. Rul. 80-116
 - Rev. Rul. 78-354
 - Rev. Rul. 77-198
 - Rev. Rul. 75-308
 - Rev. Rul. 74-57
 - Most are either purely obsolete (Notice 2010-29), or are superseded by more recent guidance (Rev. Rul. 2020-19). A majority address changes in basis.
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| Rev. Rul. 2002-6 | Rev. Rul. 70-568 |
| Rev. Rul. 94-74 | Rev. Rul. 70-192 |
| Rev. Rul. 80-117 | Rev. Rul. 69-444 |
| Rev. Rul. 80-116 | Rev. Rul. 65-240 |
| Rev. Rul. 78-354 | Rev. Rul. 65-233 |
| Rev. Rul. 77-198 | Rev. Rul. 65-143 |
| Rev. Rul. 75-308 | Notice 2010-29 |

Published Guidance/Campaigns

Rev. Rul. 2020-19

- Issued concurrently with the final regulations
- Published at request of life insurance industry
- Addresses what constitutes a change in basis for computing reserves under section 807(f)
- Updates prior guidance that was obsoleted by the TCJA and by IRS administratively, most importantly Rev. Rul. 94-74
- Applies long-established rule that changes in basis are a subset of changes in accounting method for federal income tax purposes. Thus, changes in fact and changes in estimate are not changes in basis.

Rev. Rul. 2020-19

Five situations ARE changes in basis:

- Impermissible application of the 92.81% factor of Section 807(d);
- Imposition of new computational requirements for reserves on previously issued variable annuity contracts, applicable to the determination of reserves as of Year 4, but for contracts issued after Year 1;
- Imposition of new computational requirements for variable annuity contracts, applicable to the determination of reserves as of Year 4, but only for contracts issued beginning in Year 4;
- Imposition of new Actuarial Guideline that applies to the determination of reserves in Year 3 for contracts issued before Year 1; and
- Change in mortality table used to compute Net Premium Reserve under VM-20.

Rev. Rul. 2020-19

Five situations ARE NOT changes in basis:

- Change from using the Deterministic Reserve to using the sum of the policy Net Premium Reserves under VM-20, because the year-over-year comparison is inherently part of the NAIC-prescribed reserve method;
- Change in company experience mortality rates used to compute Deterministic Reserve that occurs by operation of VM-20;
- Change from reporting 92.81% of NAIC-prescribed reserve to reporting contract net surrender values, that occurs by operation of section 807(d);
- Omission of policy cells for certain contracts; and
- Addition of new benefit to existing policies.

LB&I Campaigns

“The launch of campaigns is the culmination of an extensive effort to redefine compliance work and build a supportive infrastructure. The campaign program allows LB&I to address significant compliance and resource and deployment of resources, training and tools, metrics and feedback.”

Source: [irs.gov](https://www.irs.gov) website

LB&I Campaigns

- News Release September 14, 2020 identified four new campaigns, two of which concern life insurance reserves
 - Computation of Life Insurance Reserves. Campaign will focus on technical issues that arise in connection with the TCJA reserve transition adjustment and implementation of changes to section 807(d).
 - Re-Computation of Life Insurance Reserves. Campaign will focus on companies that elected under section 807(d)(4) of pre-TCJA law to recompute interest rate for determining reserves every 5 years. Prior IRS guidance, CCA 201939003, took position election could not be made on amended return, and could not be made for contracts issued in 2012 or earlier.
- There are now a total of 57 campaigns, each organized around a single compliance issue.

IRC Section 807(d) Computation of Life Insurance Reserves Campaign

- Section 13517 of the TCJA amended IRC section 807(d) to provide a new method for computing life insurance reserves, effective for tax years beginning after December 31, 2017
- The TCJA provided a transition rule that requires any difference between
 - (i) the amount of life insurance reserves with respect to any contract as of the close of the taxable year preceding the first taxable year beginning after December 31, 2017, computed using the method prescribed by the TCJA, and
 - (ii) the amount of such reserves computed using the method applied prior to amendment by the TCJA
- To be taken into account ratably over the eight succeeding taxable years

IRC Section 807(d) Computation of Life Insurance Reserves Campaign

- The goal of the campaign is to examine Forms 1120-L filed by life insurance companies for their 2017 and/or 2018 taxable years (and any related and subsequent year returns)
- The IRS seeks to understand how taxpayers implemented TCJA Section 13517
- Campaign will ensure compliance with provisions of TCJA
- Campaign will identify compliant and non-compliant technical issues
- The treatment stream for the campaign is issue based examinations

See <https://www.irs.gov/businesses/corporations/lbi-active-campaigns#collapseCollapsible1602113741267>

IRC Section 807(d) Re-computation of Life Insurance Reserves Campaign

- *Background:* IRS Office of Chief Counsel issued Chief Counsel Advice (CCA) 201939003 (June 27, 2019) addressing the making of an election under former IRC section 807(d)(4)(A)(ii)
- The CCA concludes that the doctrine of election precludes a taxpayer from making an IRC section 807(d)(4)(A)(ii) election on an amended return
- Doctrine of election also precludes a taxpayer from making an IRC section 807(d)(4)(A)(ii) election on an originally filed 2017 return with respect to contracts issued five or more years prior to 2017

IRC Section 807(d) Re-computation of Life Insurance Reserves Campaign

- IRC former section 807(d)(4)(A)(ii) election
 - (ii) Election to recompute Federal interest rate every 5 years.
 - (I) In general. In computing the amount of the reserve with respect to any contract to which an election under this clause applies for periods during any recomputation period, the [AFIR] shall be the annual rate determined by the Secretary under section 846(c)(2) for the 1st year of such period. No change in the [AFIR] shall be made under the preceding sentence unless such change would equal or exceed 1/2 of 1 percentage point.
 - (II) Recomputation period. For purposes of subclause (I), the term “recomputation period” means, with respect to any contract, the 5 calendar year period beginning with the 5th calendar year beginning after the calendar year in which the contract was issued (and each subsequent 5 calendar year period).
 - (III) Election. An election under this clause shall apply to all contracts issued during the calendar year for which the election was made or during any subsequent calendar year unless such election is revoked with the consent of the Secretary.

IRC Section 807(d) Re-computation of Life Insurance Reserves Campaign

- A taxpayer that has made an improper IRC section 807(d)(4)(A)(ii) election for contracts issued in 2012 and prior years may also be at risk for improperly calculating its transition adjustment under section 13517(c)(3) of the TCJA
- The goal of campaign is to examine original and amended Forms 1120-L filed by life insurance companies for their 2017 and/or 2018 taxable years (and any related and subsequent year returns) to ensure compliance, and to identify compliant and non-compliant technical issues
- The treatment stream is issue based examinations

See <https://www.irs.gov/businesses/corporations/lbi-active-campaigns#collapseCollapsible1602113741259>

Retired Campaigns?

- In addition to listing “active” campaigns, the IRS maintains a list of “retired” campaigns
- *“The campaigns listed below have concluded. Even though these issues are no longer campaigns, they may still be identified and included in the scope of an LB&I examination. Further, LB&I may re-evaluate these issues and could decide to reinstate any campaign at a future date”*
- One of the retired campaigns is the Deferred Variable Annuity Reserves & Life Insurance Reserves IIR Campaign

Retired Campaigns?

- The reserves campaign concluded with the issuance of an Industry Director directive
- The issues the IRS intended to address included the amounts to be taken into account in determining tax reserves for both deferred variable annuities with Guaranteed Minimum Benefits, and Life Insurance contracts
- The campaign's objective was “to collaborate with industry stakeholders, Chief Counsel and Treasury to develop published guidance that provides certainty to taxpayers regarding these related issues”

See <https://www.irs.gov/businesses/corporations/lbi-retired-campaigns#collapseCollapsible1592921816427>

Industry Director Directives

- On July 29, 2020, the LB&I Commissioner issued a memo that affects the insurance company provisions of the Internal Revenue Manual, and Industry Director directives more generally
- The LB&I Policy Office is charged with applying a consistent approach to LB&I operations to make sure operations are aligned with strategic goals
- LB&I Policy Office will be reviewing all Industry Director directives and either revoking them or incorporating them into the IRM
- Signatory authority for certain sections of the IRM, including those applicable to insurance companies, has been transferred to the Assistant Deputy Commissioner Compliance Integration

Insurance Industry Director Directives

- IRC §807: Large Business and International (LB&I) Directive Related to Principle Based Reserves for Variable Annuity Contracts (AG 43/VM-21) and Life Insurance Contracts (VM-20) (August 24, 2018)
 - LB&I Control No: LB&I-04-0818-015
 - Affected IRM: IRM 4.51.2
- IRC §446: LB&I Directive Related to Hedging of Variable Annuity Guaranteed Minimum Benefits by Insurance Companies (July 17, 2014)
 - LB&I Control No: LB&I-04-0514-0050
- IRC §166: LB&I Directive Related to Partial Worthlessness Deduction for Eligible Securities Reported by Insurance Companies (July 30, 2012)
 - LB&I Control No: LB&I-4-0712-009

Industry Director Directives

- Examination of Dividends Received Deduction on Separate Accounts of Life Insurance Companies (May 20, 2010)
 - LMSB Control No: LMSB-4-0510-015
 - Impacted IRM 4.42.4
- Field Directive on Examination of IRC §847 (January 13, 2006)
 - *“Please be advised that Section 13516 of the Tax Cuts and Jobs Act (Pub. L. No. 115-97) repealed IRC section 847 for taxable years beginning after December 31, 2017”*

TCJA Changes to Life Settlements

Life Settlement Reporting Tax Cuts and Jobs Act

- Three changes in TCJA to taxation and reporting of life settlement transactions
- Section 6050Y—New information reporting requirements
 - Acquirers—Requirements to file under section 6050Y(a), including Form 1099-LS
 - Issuers—Requirements to file under section 6050Y(b), including Form 1099-SB
 - Payors—Requirements to file under section 6050Y(c), including amended Form 1099-R
- Section 101(a)(3)—Amendments to the transfer for value rules
 - Exceptions from transfer for value rules not applicable to reportable policy sales
- Section 1016(a)(1)(B)—Determination of adjusted basis upon sale of policy by policyholder
 - Generally reduces amount of gain recognized on sale by policyholder

Life Settlement Reporting Background

- Life settlement transactions typically involve the sale of a life insurance policy by the policyholder to a new policyholder (acquirer)
- Life insurance policy remains in force; no surrender under section 72
 - New policyholder pays remaining premiums insuring original insured life
 - Upon death of insured, death benefits paid to new policyholder (acquirer)
- Sale by policyholder taxable under section 1001

Life Settlement Reporting

Legislative Intent

- Problem: Tax gap between tax due by taxpayers and third-party reporting obligations
 - Tax due by policyholder on the sale of their policies
 - Tax due on payment of death benefits to acquirers
- Solution: New section 6050Y
 - New information reporting obligations for acquirers and issuers with respect to “reportable policy sales” and for any transfer of a life insurance contract to a foreign person
 - New information reporting obligations for payors of reportable death benefits

Life Settlement Reporting Mechanics

- Step 1: Acquirer Reporting
 - Acquirer of a life insurance policy in a reportable policy sale has obligation to file Form 1099-LS with IRS
 - Acquirer must give notice (“reportable policy sale statement” or “RPSS”) to issuer of policy
 - Acquirer also must furnish statement to each payment recipient, including broker
- Step 2: Issuer Reporting
 - Upon RPSS, issuer must furnish statement to seller
 - Receipt of RPSS triggers issuer’s obligation to file Form 1099-SB with IRS
 - If no RPSS received from acquirer, then no trigger of reporting by issuer
 - Issuer must also file Form 1099-SB upon notice of transfer of policy to a foreign person
- Step 3: Payor reporting
 - Reporting applies if received RPSS or knowledge of any issuer receiving RPSS
 - Payors of reportable death benefits must issue Form 1099-R to IRS
 - Payor must furnish statement to payment recipient

Life Settlement Reporting

Key Issues

- Indirect Acquisitions
 - Adoption of 50% of gross value of assets test for C corporations
- Treatment of Commissions and Expenses
 - Entire amount of consideration in a reportable policy sale must be reported, including the portion paid as a commission
 - Ancillary expenses must be reported unless reported under sections 6041 or 6041A
 - Final regulations exempt reporting with respect to non-seller payment recipients that receives aggregate payments of less than \$600

Life Settlement Reporting

Key Issues

- Transfers to foreign persons
 - Issuer not considered to have notice of a transfer to a foreign person unless the issuer receives notice that includes foreign indicia, such as a notice of change of address to a foreign address
 - Issuers may rely on a Form W-9 to determine owner's status
 - Reportable death benefits paid to a foreign person that must be reported on Form 1042-S are not required to be reported on Form 1099-R
- Treatment of indemnity reinsurance
 - Typically the ceding company will be responsible for reporting because company administering policy receives the Form 1099-LS notice from acquirer; so reinsurer never in the chain of reporting obligations
 - If reinsurer receives Form 1099-LS notice, reinsurer and ceding company can agree on where incidence of reporting lies to avoid duplicative reporting

Life Settlement Reporting

Key Issues

- Surrender values
 - No relief for issuers from reporting surrender values
 - Issuers may have to adapt their information reporting systems
- Gratuitous transfers to U.S. persons
 - Preamble to final regulations
 - No reporting on Form 1099-LS or RPSS required by acquirer if no payment received
 - Because issuer does not receive RPSS from acquirer, no trigger of issuer reporting on Form 1099-SB
 - Payor of reportable death benefits has no obligation to report on Form 1099-R if no RPSS or actual knowledge of issuer's receipt of RPSS

Life Settlement Reporting

Key Issues

1035 Exchanges

- Policyholder's assignment of old contract to issuer of new contract in a 1035 exchange is not an acquisition by insurance company; not an automatic reportable policy sale
- If policyholder of a new contract issued in a 1035 exchange has no substantial family, business, or financial relationship with insured, then reportable policy sale
 - Unlikely due to state laws on insured interest requirement
- Certain common 1035 exchanges may be considered a reportable policy sale (e.g., COLI transactions, transfers to certain trusts)
 - Special reporting rules apply if a 1035 exchange results in a reportable policy sale

Transfers for Value Background

- Section 101(a)(2) generally limits the section 101(a)(1) exclusion for death benefits for policies transferred for value
 - Exclusion limited to sum of consideration paid by transferee and premiums paid by transferee following the transfer
 - Certain transfers are excepted from unfavorable treatment under the transfer for value rules, including transfers in which the carryover basis exception applies
 - Carryover basis exception applies where contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor (e.g., a corporate reorganization treated as an asset sale)
- New section 101(a)(3) enacted in TCJA
 - Limits application of the carryover basis exception
 - Carryover basis exception is not available if a transfer is a reportable policy sale

Transfers for Value

Section 101(a)(3)

- Carryover basis exception is not available if a transfer is a reportable policy sale. Section 101(a)(3)(A).
- To constitute a reportable policy sale, there must be a lack of a substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract. Section 101(a)(3)(B); Treas. Reg. 1.101-1(c)(1), 1.101-1(c)(2)(v).
- Substantial relationships defined
 - Substantial family relationship – Treas. Reg. 1.101-1(d)(1)
 - Substantial business relationship – Treas. Reg. 1.101-1(d)(2)
 - Substantial financial relationship – Treas. Reg. 1.101-1(d)(3)

Section 1016(a)(1)(B)

Determination of Gain/Loss on Sale

- Former IRS position—adjusted basis of a life insurance or annuity contract must be reduced by mortality expenses or other reasonable charges under the contract (i.e., cost of insurance charges)
 - Rev. Rul. 2009-13 – effective August 26, 2009
 - Rev. Rul. 2009-14
- Section 1016(a)(1)(B)—in determining the basis of a life insurance contract or an annuity contract, no adjustment is made for mortality expenses or other reasonable charges under the contract
 - Enacted in Tax Cuts and Jobs Act
 - Effective for transactions entered into on or after August 26, 2009

Section 1016(a)(1)(B)

Rev. Rul. 2020-5

- Rev. Rul. 2020-5—modified Rev. Rul. 2009-13 and Rev. Rul. 2009-14 to the extent inconsistent with section 1016(a)(1)(B)
- Provides revised scenarios under prior guidance
- Generally reduces amount of gain realized on sale by policyholder
 - Some former gains now treated as losses
- No change to character of gain or loss recognized
- Refund claims may be available, subject to statute of limitations

Section 1016(a)(1)(B)

Rev. Rul. 2020-5: Revised Scenarios

	Rev. Rul. 2009-13 (Scenario 2)	Rev. Rul. 2020-5
Facts	<ul style="list-style-type: none"> • Sale of cash value policy from policyholder (A) to (B) • Surrender value = \$78,000 • Amount of consideration = \$80,000 • Investment in the contract = \$64,000 • Inside build-up = \$14,000 • COI charges = \$10,000 	
Analysis & Conclusion	<ul style="list-style-type: none"> • Adjusted basis = \$54,000 (\$64,000 investment in the contract <i>minus</i> \$10,000 COI charges) • Gain = \$26,000 (\$80,000 consideration <i>minus</i> \$54,000 adjusted basis) • Ordinary income = \$14,000 (substitute for inside build-up) • Capital gain = \$12,000 (\$26,000 gain <i>minus</i> \$14,000) 	<ul style="list-style-type: none"> • Adjusted basis = \$64,000 (\$64,000 investment in contract with no subtraction for COI charges) • Gain = \$16,000 (\$80,000 consideration <i>minus</i> \$64,000 adjusted basis) • Ordinary income = \$14,000 (substitute for inside build-up) • Capital gain = \$2,000 (\$16,000 gain <i>minus</i> \$14,000)

Section 1016(a)(1)(B)

Rev. Rul. 2020-5: Revised Scenarios

	Rev. Rul. 2009-13 (Scenario 3)	Rev. Rul. 2020-5
Facts	<ul style="list-style-type: none"> • Sale of term policy from policyholder (A) to acquirer (B) • Premium = \$500 monthly • A's holding period = 89.5 months • A's premiums paid at time of sale = \$45,000 • Amount of consideration = \$20,000 • COI charges = \$44,750 	
Analysis & Conclusion	<ul style="list-style-type: none"> • Adjusted basis = \$250 (\$45,000 premium paid <i>minus</i> \$44,750 COI charges) • Gain = \$19,750 (\$20,000 consideration <i>minus</i> \$250 adjusted basis) • All gain treated as capital gain 	<ul style="list-style-type: none"> • Adjusted basis = \$45,000 (\$45,000 premiums paid with no reduction for COI charges) • Loss = \$25,000 (\$45,000 adjusted basis <i>minus</i> \$20,000 consideration) • All loss treated as capital loss