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Client Information: Impact of Final Regulations on Reportable Policy Sales in the COLI/BOLI Marketplace

Disclaimer

This memorandum is not intended to constitute tax or legal advice.

The Regulation: http://info.aalu.org/e/471661/-2019-10-31-pdf-2019-23559-pdf/dj89r6/533717939?h=NBVCid_ieOEHF-Npkf4y9LpnXfHRPvx7lw0uJymfSRM

Publication Date: October 31, 2019

Background

The Tax Cuts and Jobs Act of 2017 (the “**TCJA**”) modified the prior-law exemptions of the Transfer for Value Rules (“**TFV Rules**”) to include new Reportable Policy Sale (“**RPS**”) requirements that apply to all transfers for valuable consideration. *This rulemaking has important implications for the company-owned life insurance (“**COLI**”) and bank-owned life insurance (“**BOLI**”) marketplaces and will affect the taxation of death benefits on some contracts.* The Treasury Department recently released regulations offering several ways to preserve the pre-TCJA treatment of COLI and BOLI contracts.

Commentary

The final regulations are responsive to the concerns raised by the life insurance industry with respect to the potential impact of the RPS rules on ordinary course transactions, such as mergers and acquisitions. Foremost, the guidance in the final regulations may be applied retroactively to the TCJA's enactment date (Dec. 2017), protecting clients from the unintended consequences of the unclear statutory rules enacted by the TCJA. In addition, the final rule includes nine (9) exceptions that preserve the prior-law tax treatment of the death benefits with respect to policies transferred in ordinary course transactions. Satisfaction of any one of the nine will preserve the prior law tax treatment.

The following table highlights the exceptions most likely applicable to the broadest number of taxpayers:

| Analysis for C Corporations | Analysis for S Corporations |
|---|---|
| <p>Ordinary course stock transactions involving C corporations are generally exempt from the reportable policy rule. The exception provides that there is no "indirect transfer" of life insurance where:</p> <ul style="list-style-type: none"> • (a) the acquirer becomes a beneficial owner of a C corporation that owns life insurance contracts; and • (b) life insurance contracts do not comprise more than 50 percent of the gross value of assets of such C corporation immediately before the acquisition. | <p>Step 1 – Grandfather Provision. In instances where an acquiror purchases an entity through a stock transaction, each COLI/BOLI policy indirectly transferred to the acquiror through that purchase is not an RPS, <u><i>so long as the entity held an interest in the life insurance policy prior to January 1, 2019.</i></u></p> <p>Step 2 – Relationship Exceptions. If the acquired S Corporation (regardless of transaction form) has COLI/BOLI policies acquired after January 1, 2019, the insurance policies may still qualify for an exception if the insured has a substantial financial or business relationship with the acquiror (or acquiree).</p> |

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| Check the Remaining Exceptions. If the exceptions described above do not fit your circumstance, please determine with your advisor whether one of the remaining exceptions applies. | |

For more information please contact your financial advisor. They will help you determine whether existing COLI/BOLI contracts qualify for the exceptions available under the rule and can help structure COLI/BOLI contracts to ensure that they retain their tax advantages. Life insurance policies transferred for valuable consideration that do not meet the exceptions included in the RPS final rule will have their excludable portion of the death benefit limited to the consideration paid for the policy plus any subsequent premiums paid on the policy.

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This product was developed for AALU Members through the work of AALU staff, the Federal Policy Group, and the volunteer members of AALU's COLI/BOLI Working Group. If you have any questions, please contact [Armstrong Robinson](#) at 202-772-2493 or [Joseph Conrad](#) at 202-742-4636.

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Questions?

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