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Implications of the Treasury Department's Final Regulations on Reportable Policy Sales for 1035 Exchanges Made by Businesses

On October 31, the Treasury Department released its final regulations on Reportable Policy Sales (RPS) final rule. In addition to clarifying the tax implications for company-owned life insurance (“**COLI**”) and bank-owned life insurance (“**BOLI**”) transferred in ordinary course transactions, the rule also cemented the Treasury Department’s position on how the requirements will apply with respect to section 1035 exchanges made by businesses.

The rule is twofold:

1. First, life insurance companies acquiring an old life insurance policy pursuant to a section 1035 exchange is not treated as a RPS.
2. More importantly, the business exchanging a policy, the acquisition of the new policy is treated as an RPS **unless** the policyholder qualifies for one of the “substantial relationship” (with the insured) exemptions described in points in 6, 7, 8, and 9 of [our Washington Report Newswire analysis](#). **Thus, for section 1035 exchanges on policies written on the life of a former employee, for example, the business may lack a sufficient substantial relationship with the insured**

in order to avoid an RPS status, limiting the excludable portion of the death benefit to the consideration paid for the policy plus any subsequent premiums paid on the policy.

These clarifications clearly apply to section 1035 exchanges that occur after October 31, 2019. For 1035 exchanges which occurred between the time the TCJA was enacted and October 31, 2019, taxpayers have the discretion to either apply these rules retroactively or simply apply the statutory language contained in the TCJA. If parties decide to retroactively apply the final regulation, it is clear that acquisitions of new policies through section 1035 exchanges are reportable policy sales unless they qualify for a substantial relationship exemption. For taxpayers who choose to **not** apply the rules retroactively and simply apply the broad statutory language, the result is unclear (but seemingly at least as likely to result in a reportable policy sale).

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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