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TAXATION OF LIFE SETTLEMENTS—UNANSWERED QUESTIONS AFTER REV. RULS. 2009-13 AND 2009-14

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Taxation of Life Settlements—Unanswered Questions After Rev. Ruls. 2009-13 and 2009-14

By David L. Keligian and Robert W. Larsen

For the most part, the Service's answer to the question, "what is the tax treatment of the proceeds of a life settlement transaction?," will be "ordinary income." Given the lack of useful precedent, the IRS seems to have chosen the result that provides the most amount of revenue, despite the fact that at least some purchasers of such life insurance would appear to have an investment motive entitling them to capital gains treatment.

Two Revenue Rulings issued last May addressed the income tax consequences of surrenders, sales, and the receipt of death benefits from life insurance policies. The factual circumstances in the Rulings involved insureds, sales of life insurance policies by insureds to third parties, and sales of policies by third-party buyers to other third-party buyers.

These Rulings deal with the growing number of transactions involving "life settlements"—the sale of life insurance policies by their owners to third-party investors. As will be discussed below, the conclusions reached in Rev. Rul. 2009-13, 2009-21 IRB 1029, and Rev. Rul. 2009-14, 2009-21 IRB 1031, combine elements of a straightforward application of established law (such as the transfer-for-value rules of Section 101(a)(2)), with holdings that have little reasoning or support behind them.

LIFE SETTLEMENTS

During the last several years, there has been increasing discussion and marketing activity concerning life settlements—the sale of an unwanted life insurance policy (which can either be a term or permanent policy) by an insured to third parties who do not have an insurable interest in the life of the policy owner.

Such transactions have given rise to the term "stranger-owned life insurance," and have been the topic of regulatory concern and even lawsuits.[1] Although there seems to be a trend towards restricting life settlement transactions by insurers and insurance regulators,[2] they have legitimate uses. From the standpoint of the insured, and putting aside those transactions entered into for the sole purpose of selling the policy, life settlement transactions make sense when the "market value" of a policy—the amount an investor is willing to pay for it—exceeds the cash value the insured could obtain for the policy directly from the issuer. Such situations can arise where the policy owner has outlived the policy beneficiaries or otherwise no longer needs the policy, the policy owner or family members require cash, or where a different policy is more appropriate (for example, a situation where a single life policy intended to provide liquidity for estate tax purposes can be exchanged for a survivorship policy offering more coverage).

Life settlements raised several tax issues, the answers to some of which remain unclear. The major issues include the circumstances in which the original

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owner and investors in life policies could claim capital gains treatment, the differing consequences of surrendering the policy to the issuing insurance company as compared to selling it to a third party, and how policy holders or purchasers compute their investment in the contract or basis—two different and mutually exclusive concepts—which are separately relevant depending on how a policy is disposed of.

REV. RUL. 2009-13

In Rev. Rul. 2009-13, the circumstances involved the surrender of a life insurance contract as defined in Section 7702 (Situation 1), the sale of the same policy to an unrelated party (Situation 2), and the sale of a level premium 15-year term life insurance policy without cash surrender value to a third party (Situation 3). In each instance, Rev. Rul. 2009-13 stated that the contract in the insured's hands was not property described in Sections 1221(a)(1) through (8), i.e., one of the statutory exclusions from capital gains treatment.

In Situation 1, the contract had $78,000 in cash surrender value, $10,000 of "cost of insurance" charges collected by the issuer, and cumulative premiums paid of $64,000. In Situation 2, the facts were the same except the insured sold the policy for $80,000. In Situation 3, the insured had paid premiums totaling $45,000, the monthly premiums were $500, the contract was sold in the middle of the month, and the sale consideration was $20,000.

Situation 1. The Service's analysis of Situation 1 (the surrender of the insurance contract by the insured to the issuing insurance company) was based on Section 72(e). Section 72 (e)(5)(A) incorporates the concept of the insured's "investment in the contract." This term is defined in Section 72(e)(6) as the aggregate amount of premiums or other consideration paid for the contract less the aggregate amount received under the contract (to the extent such amounts were excludable from gross income), all as of the date the "investment in the contract" is being determined.

Discussion and marketing activity concerning 'life settlements'—the sale of unwanted policies to third parties—have increased.

The initial analysis in Situation 1 is fairly straightforward. The insured received $78,000 on the complete surrender of the contract. The insured's "investment in the contract," as defined by Section 72(e)(6), was $64,000. Consequently, the IRS treated the net difference of $14,000 as income.

IRS admitted that Section 72(e) does not specify whether the income recognized on the surrendered contract should be characterized as ordinary or capital gain.

It is significant that the IRS, while (1) admitting that Section 72(e) does not specify whether the income recognized on the surrendered contract should be characterized as ordinary or capital gain, and (2) conceding that the insurance contract was not disqualified from capital gains treatment under any of the exceptions in Sections 1221(a)(1) through (8), still held the income was ordinary. The Service relied on Rev. Rul. 64-51, 1964-1 CB 322, for the proposition that the proceeds received by the insured were ordinary income. Rev. Rul. 2009-13 then stated that "Section 1234A, originally enacted in 1981, does not change this result."

The issue in Rev. Rul. 64-51 was whether income derived by an insured nonresident alien on the surrender of, or at the maturity of, a life insurance policy was subject to withholding under Section 1441. With respect to the characterization of income from a life insurance policy, Rev. Rul. 64-51 simply cited Section 61(a)(10), which is part of the general definition of "gross income," in stating the income was "ordinary income." "Gross income," however, includes both ordinary income and capital gains.[3] Section 1001(b) and Reg. 1.1001-1(a) require a "realization" of the gain or loss, but there is nothing inconsistent with such a requirement and the surrender of a life insurance policy for cash. Thus, merely concluding that the proceeds of a policy surrender constitute "gross income" says nothing about the character of the income.

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1 For example, in an order filed on 7/10/09, a federal district court in California entered an order granting a motion for summary judgment in favor of the defendants when the plaintiff, Lincoln National Life Insurance Company, tried to argue that three insurance policies it sold to the defendants should be voided. The policies were purchased with third-party, nonrecourse premium finance loans, and were apparently purchased with the intent to sell them after the incontestability period had passed. The court recognized Lincoln's obligation to honor the insurance contracts even though it appeared they had been purchased for the express purpose of reselling them. The court cited section 10110.1(f) of the California Insurance Code in noting that although an insurable interest is required under California law when a policy is purchased, under California's statute such interests "need not exist thereafter." Even though it held for the defendants, the court noted that the "finance program skirts close to the letter, and certainly can be viewed as violating the spirit of California law." See The Lincoln Nat. Life Ins. Co. v. The Gordon R.A. Fishman Irrev. Life Tr., 2009 WL 2330771 (DC Calif., 2009). The case illustrates insurers' growing sensitivity to certain life settlement transactions.

2 Possibly in reaction to the fact that many promoters were actively soliciting prospective insureds—and in some cases offering to provide all the financing—to buy policies with the express intention of re-selling such policies to the promoters as soon as the "incontestability period" had passed.

3 See Section 61(a)(3), which includes "gains from dealings in property." Reg. 1.61-6(a) clearly states that "[g]ain realized on the *sale or exchange* of property is included in gross income" (emphasis added), and Regs. 1.61-6 (b) and 1.61-6(c) also clearly refer to assets that qualify for capital gains treatment.

One argument for ordinary income treatment might be that the surrender of a policy to the issuing insurance company does not constitute a "sale or exchange," a prerequisite for capital gains treatment. Although the surrender of a policy to an insurer may not necessarily constitute a "sale or exchange," Section 1234A treats the cancellation, lapse, expiration, or other termination of a right or obligation with respect to property which is (or would be on acquisition) a capital asset in the taxpayer's hands as a "sale or exchange."

Section 1234A originally was restricted to actively traded personal property and regulated futures contracts, and subsequently was extended to Section 1256 contracts. It was eventually expanded, however, to cover all types of property.[4] Thus, it is not clear why Section 1234A would *not* apply to the surrender of a life insurance policy to the issuer, unless the IRS is saying that a life insurance policy would not be a capital asset in the hands of the insured. If that were the case, however, it is not clear why Rev. Rul. 2009-13 makes a point of noting that Sections 1221(a)(1) through (8) are inapplicable.[5]

Better support for the IRS's position that the surrender of life insurance to the issuer is accorded ordinary income treatment seems to lie in some older authorities.

Better support for the Service's position that the surrender of a life insurance contract to the issuing insurance company is accorded ordinary income treatment seems to lie in some older authorities, which Rev. Rul. 2009-13 did not cite. Even these authorities, however, do not provide a clear rationale for their holdings.

In *Blum v. Higgins,* 150 F.2d 471, 34 AFTR 24 (CA-2, 1945), the Second Circuit held that the difference between (1) the amount constructively received[6] under an endowment policy and (2) the premiums paid for the policy was taxable as ordinary income, not capital gain. The *Higgins* opinion cited *Avery,* 111 F.2d 19, 24 AFTR 856 (CA-9, 1940), as authority.

In *Avery,* the Ninth Circuit compared section 22 of the Revenue Acts of 1932 and 1934 with section 117(f) of the Revenue Act of 1934 in determining whether the amount realized on the maturity of a life insurance policy constituted ordinary income or capital gain. Nevertheless, section 117(f) of the 1934 Act was, by its terms, applicable only to the retirement of bonds, debentures, notes, and similar debt instruments, and could be easily distinguished from life insurance policies, which were explicitly addressed in section 22 of the 1932 and 1934 Revenue Acts.

The problem, however, is the same as that noted above—section 22 dealt with exclusions from and inclusions in gross income with respect to life insurance, endowment, and annuity contracts, and not the *characterization* of such income. Section 22 of the 1932 and 1934 Revenue Acts bears some resemblance to current Section 72, but (as the Service itself recognized in Rev. Rul. 2009-13 with respect to Section 72(e)), section 22 did not specify whether the income recognized should be characterized as ordinary income or capital gain.

Situation 2. In Situation 2, the IRS analyzed the transaction from the perspective of Sections 1011, 1012, and 1016, using the taxpayer's income tax basis (and not the investment in the contract, as required by Section 72) to determine the tax consequences. The Service's analysis cited case law to bifurcate the sale of the policy into elements that resulted in both ordinary income and capital gain.

The analysis of Situation 2 bifurcated the sale of the policy into elements that resulted in ordinary income and capital gain.

The court in *London Shoe Co.,* 80 F.2d 230, 16 AFTR 1398 (CA-2, 1935), *cert. den.,* stated that a "life insurance policy ordinarily combines investment with insurance protection." *London Shoe* involved a situation where a corporation that cancelled a policy and received its cash surrender value in an amount less than the aggregate amount of premiums it paid was denied a loss deduction for the difference. The Second Circuit reasoned that the true "cost" of the policy was, "in the absence of any proof to the contrary," equal to the policy's cash surrender value, and that the difference was the amount that was paid for the benefit of receiving the insurance protection during the time the policy was in force. While supporting the Service's position in Rev. Rul. 2009-13 regarding the need for a basis reduction for the "cost of insurance," as noted below, the case adds nothing to the analysis of why surrenders of life insurance policies to the issuing insurance company must always be taxed as ordinary income. The IRS also found

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[4] TRA '97, section 1003.

[5] Section 1234A itself is not a model of clarity concerning the types of property to which it applies. The Proposed Regulations under Section 1234A do not address its scope or application except as to notional principal contracts, bullet swaps, and forward contracts. It is possible that the IRS believes that Section 1234A is inapplicable to payments that are made pursuant to the terms of the underlying contract itself, as opposed to separate payments for the lapse of certain rights thereunder. Whether this is the Service's rationale is unclear to the authors. Because Section 1234A(1) speaks of the cancellation, lapse, expiration, or other termination of a right or obligation pertaining to property that is a capital asset in the taxpayer's hands, admittedly the right or obligation Section 1234A applies to is an item that is different from the actual capital asset itself. If this is the case, rather than flatly concluding that Section 1234A did not apply, the IRS would have done better to explain its reasoning.

[6] The constructive receipt issue was based on specific facts in this case, and was not pertinent to the characterization of the income realized.

support for a basis reduction for the "cost of insurance" in *Century Wood Preserving Co.,* 69 F.2d 967, 13 AFTR 910 (CA-3, 1934).

By contrast, Rev. Rul. 70-38, 1970-1 CB 11, held that a corporation which sold life insurance policies on the lives of its officers for less than the amount of premiums paid was "not required to include in its gross income the amount received from the sale of the insurance policies to its officers." Although it has been suggested by some that Rev. Rul. 70-38 is authority for the proposition that all of the premiums paid on the policy can be used in determining the basis of that policy, the authors do not believe Rev. Rul. 70-38 resolves this issue. The Ruling does not address whether any basis reduction for the "cost of insurance" element, as was present in *London Shoe* and *Century Wood Preserving,* was involved in Rev. Rul. 70-38. Part of the problem is that the text of Rev. Rul. 70-38 is a very short paragraph which does not supply enough facts to determine whether, had there been any basis reduction for the cost of insurance, the corporation still would have suffered a loss.

Because the sale of the contract in Rev. Rul. 2009-13 was to a third party, the IRS held that Section 72 did not apply. Nevertheless, the Service applied the "substitute for ordinary income" doctrine to hold that a portion of the sales proceeds should be taxed as ordinary income.[7]

In Situation 2, the IRS first determined that the taxpayer's basis was not the $64,000 of premiums paid, but was only $54,000—the $64,000 premiums paid less the $10,000 charged by the insurance company as the "cost of insurance."[8] The Service then determined that the taxpayer had to recognize $26,000 of income on the sale, i.e., the excess of the $80,000 realized over the $54,000 adjusted basis. The IRS then bifurcated the total gain recognized. The ordinary income element was measured by the $14,000 inside build-up on the life insurance contract (determined by subtracting the $64,000 of aggregate premiums paid from the $78,000 cash surrender value). Only the remaining $12,000 was recognized as long-term capital gain.

Is the substitute for ordinary income rationale appropriate to a policy that depends on a basket of common stocks or other equity instruments in determining inside build-up?

At first blush, the recognition of capital gain may appear beneficial. Nevertheless, under facts involving the receipt of only $2,000 more than in Situation 1, in Situation 2 the sale of the policy to the third party resulted in $12,000 more in realized gain. Because of the $10,000 reduction in the taxpayer's basis for the cost of insurance (an adjustment that does not occur under Section 72), the $10,000 cost-of-insurance charge resulted in $10,000 of capital gain incurred by the taxpayer that was not present in Situation 1.

Capital gain implications of Situation 2. As noted above, *London Shoe* stated that a life insurance policy combines investment with insurance protection. Some confusion concerning capital gains treatment comes into the picture under the "substitute for ordinary income" doctrine discussed in Situation 2.

For example, in *Arnfeld,* 163 F. Supp. 865, 2 AFTR2d 5336 (Ct. Cl., 1958), the court applied the "substitute for ordinary income" doctrine to tax the proceeds of a third-party sale of a life insurance policy as ordinary income. In doing so, however, the Court of Claims made a point of mentioning the fixed 3.5% rate of return that was compounding annually on amounts deposited under the contract in holding that the excess of the sales proceeds over the premiums paid should be taxed as ordinary income. *Arnfeld* stated: "Certainly, it cannot be said that the enhancement in value of corporate stock, affected as it is by a myriad of economic factors, bears any material resemblance to the predictable growth in value of an annuity policy."

The question is whether application of the "substitute for ordinary income" rationale is appropriate to a policy that is, for example, dependent on a basket of common stocks or other equity instruments in determining its inside build-up. See also *Gallun,* 327 F.2d 809, 13 AFTR2d 660 (CA-7, 1964), *aff'g* TCM 1963-167, where the Seventh Circuit quoted the Tax Court's justification for its conclusion that amounts should be taxed as ordinary income, in part, by stating that the gain was "*primarily* attributable to accumulated interest, taxable to petitioners as ordinary income upon receipt..." (emphasis by the Tax Court).

The facts in Rev. Rul. 2009-14, Situations 1 and 2, most closely correspond to those of an investor who purchases a capital asset and holds it to realize an investment return.

Cost of insurance. The position in Situation 2 explaining the treatment of the "cost of insurance" element of an insurance contract that is sold (as opposed to surrendered to the issuing insurance company) is supported by the cases cited in Rev. Rul. 2009-13. Nevertheless, the IRS has not addressed how the "cost" of the life insurance benefit received during the

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7 The Service's assumption was that because the inside build-up of the policy would be taxed as ordinary income if the contract were surrendered, a similar amount must be recognized as ordinary income in Situation 2 even though there was no surrender of the contract. Thus, the holding in Situation 2 is based, at least in part, on the Service's holding in Situation 1.

8 Thus, even if ordinary income treatment is required, one potential advantage of surrendering a policy to the insurer is that Section 72(e)(5) does not require a deduction for "cost of insurance" charges, even though the taxpayer has received a benefit from the coverage. By contrast, as will be seen below, this charge results in more income subject to tax in Situation 2.

time the policy is held by the seller should be measured. Definitive guidance on this issue would be helpful.

Situation 3. Situation 3 is fairly straightforward. Although the taxpayer received $20,000 in proceeds, all but $250 of the cumulative $45,000 of monthly premiums paid was treated as the cost of the insurance protection. The $250 that the Service allowed as a deduction from the $20,000 of sales proceeds was the portion of the $500 monthly premium that was unexpired (i.e., because the policy was sold only halfway through the month).

Given that Section 72(e) does not characterize income, there certainly are grounds for distinguishing the result of a sale from the surrender of a policy to the insurer.

In this situation, because the policy had no cash surrender value, the IRS held that the "substitute for ordinary income" doctrine did not apply, and because the contract had been held for more than one year, the $19,750 of income would be treated as long-term capital gain.

General comments on Rev. Rul. 2009-13. One point that is clear is that, according to the Service, a life insurance policy—even if sold by the insured—can be afforded capital gains treatment. Under the logic of Rev. Rul. 2009-13, however, the capital gains treatment *depends on the manner in which the policy is disposed of.* Where the insured is the seller, the IRS requires a sale to a third party, not a surrender to the issuer.

In addition, the inside build-up of any permanent policy should, in the Service's view, be taxed as ordinary income. The extent to which this would be true if the policy's inside build-up was attributable entirely to equity-based vehicles is not clear, but arguably such policies should be distinguished from the old cases holding that a policy's inside build-up was attributable to accrued interest and hence should be taxed as ordinary income.

REV. RUL. 2009-14

Rev. Rul. 2009-14 also described three situations. In Situation 1, the purchaser of a policy from an insured received a death benefit on the insured's death. In Situation 2, a purchaser of the policy from the insured sold it to another unrelated party. Finally, in Situation 3, a foreign corporation not engaged in a U.S. trade or business purchased the policy from the insured and then received a death benefit on the insured's death. As with Rev. Rul. 2009-13, Rev. Rul. 2009-14 combines elements of established law with holdings that have little support.

Situation 1. In Situation 1, the insured was a U.S. citizen who sold a life insurance contract for $20,000 to an unrelated U.S. person. The policy was a level-premium, 15-year term life insurance contract without cash surrender value. The contract in the third-party purchaser's hands was not property described in Sections 1221(a)(1) through (8). On the death of the insured, the insurance company paid $100,000 to the purchaser by reason of the insured's death.

The Service's analysis of this situation is straightforward and uncontroversial. The IRS applied the transfer-for-value rule of Section 101(a)(2) to conclude that the purchaser of the policy could not exclude the entire death benefit, but instead could exclude only those amounts equal to the actual consideration paid for the policy and any other consideration (such as premiums) subsequently paid by the purchaser.

In Situation 1, the purchaser received $100,000 in death benefits. In addition to the purchase price of $20,000, the purchaser paid $9,000 in post-purchase premiums. The purchaser therefore realized $71,000 of gross income (the difference between the $100,000 of death benefits and the $29,000 amount excluded under Section 101(a)(2)).

Practice Notes

As a practical matter, taxpayers engaging in life settlement transactions with facts similar to those set forth in Rev. Ruls. 2009-13 or 2009-14, and taking a position on the tax consequences different from the conclusions in those Rulings that the proceeds are taxed as ordinary income, may have to disclose such positions to avoid penalty. Disclosure might not be necessary if the taxpayer can point to substantial authority for his position, but as noted in this article, such substantial authority would seem difficult to locate.

It is in the analysis of the character of the income recognized by the purchaser where one could take issue with Rev. Rul. 2009-14. Although the IRS conceded that the life insurance contract was not excluded from capital gains treatment by virtue of the exceptions in Sections 1221(a)(1) through (8), and admitted that the contract was a capital asset in the purchaser's hands, the Service still held that the proceeds were taxable as ordinary income.

IRS has concluded that such income always must be taxed as ordinary income, even if the policy owner had solely an investment intent with respect to the policy.

There was no support for this conclusion—merely the self-serving statement that "[n]either the surrender of a life insurance or annuity contract nor the receipt of a death benefit from the issuer under the terms of the contract produces a capital gain." Perhaps the IRS felt

that this result was mandated by Section 72(e). As the Service noted in Rev. Rul. 2009-13, however, Section 72(e) does not deal with the characterization of gain. That leaves one with the same problem as under Situation 1 in Rev. Rul. 2009-13—Rev. Rul. 64-51 cites Section 61(a)(10), but Section 61(a) merely defines "gross income," not the character of such income.

Of the six scenarios presented in Rev. Ruls. 2009-13 and 2009-14, Situations 1 and 2 of Rev. Rul. 2009-14 present facts that most closely correspond to those of an investor who purchases a capital asset and holds it to realize an investment return. Given that Section 72(e) does not address whether income received under that subsection should be characterized as ordinary income or capital gain, there certainly are grounds for distinguishing the result in Situation 1 from the treatment that occurs when an insured surrenders a policy to a life insurance company.

Situation 2. The ordinary income vs. capital gain issue is highlighted in Situation 2, where the facts are the same as in Situation 1 except that the insured did not die. In Situation 2, the first purchaser sold the insurance contract to an unrelated party for $30,000.

The reasoning in Situation 2 is straightforward. Analyzing the seller's basis from the perspective of Sections 1011, 1012, and 1016, the Service compared the $30,000 received on the sale of the contract to the seller's $29,000 of basis, resulting in a $1,000 gain. Because the insured was not the seller, the basis was not reduced by any "cost of insurance" charges, and the sales proceeds were held to be taxable as capital gains because, as a term contract without any cash value, the "substitute for ordinary income" doctrine was inapplicable. The only real controversy is why, given exactly the same motivation on the part of the seller in both Situation 1 and Situation 2, the sale in Situation 2 is taxed as capital gains while the receipt of proceeds as a payment from the insurance company itself is not.

Situation 3. Situation 3 involved the same facts as Situation 1, with the exception that the purchaser of the contract was a foreign corporation not engaged in a U.S. trade or business. The Service considered the tax consequences of this sale and held that the source of the insurance proceeds was in the U.S. because both the insured and the insurance company were in the U.S. Under the same rationale as Situation 1, the IRS held the income to be ordinary.

CONCLUSION

Given the increase in the number of life settlement transactions, the Service's reliance in Rev. Rul. 2009-13 and Rev. Rul. 2009-14 on old cases that can be factually distinguished from some modern insurance products leaves an unwelcome gap in the analysis of the tax consequences of such transactions. While recognizing that Section 72(e) does not address the character of income recognized, the IRS has concluded that such income always must be taxed as ordinary income, even if the policy owner had solely an investment intent with respect to the policy. Arguably, however, the different circumstances and motivations between the owner of a contract who is the insured as opposed to someone who purchases the contract purely for investment purposes should enter into the analysis of whether proceeds constitute capital gains or ordinary income.

In those circumstances where taxpayers have facts that result in adverse consequences under Rev. Rul. 2009-13 or Rev. Rul. 2009-14, taking a position contrary to those Rulings would require a showing of "substantial authority" (a likelihood that the taxpayer's position is somewhere between 50% and the lower standard applicable to the negligence penalty under Section 6662). Alternatively, the taxpayer can take the position that there is a "reasonable basis" for a position contrary to the conclusions mandated by Rev. Rul. 2009-13 and Rev. Rul. 2009-14 if disclosure of that position is made on Form 8275.

In the case of the "substantial authority" standard, the taxpayer must rely on the Code, the Regulations, Revenue Rulings and Revenue Procedures, court cases, congressional intent as expressed in committee reports, joint explanatory statements of managers, and similar materials, or additional items such as private letter rulings and technical advice issued by the IRS. The problem is that, as to many of the issues addressed in this article, such authorities appear scarce.

Proposed reporting rules. The Obama Administration's technical description of its tax proposals (the "Green Book") reflects an apparent concern with making sure the growing volume of life settlements is being properly reported. The Green Book contains a proposal requiring a person or entity who purchases an interest in an existing life insurance contract with a death benefit of $1 million or more to report the purchase price, the buyer's taxpayer identification number, the seller's taxpayer identification number, and the issuer and policy number to the IRS, the insurance company, and the seller.

There is also a proposal to modify the exceptions to the transfer-for-value rule so that none of those exceptions would apply where, in effect, someone is purchasing a policy. In such circumstances, the insurer would be required to report to both the IRS and the payee information on the gross payment, an estimate of the buyer's basis, and the buyer's tax identification number. These proposals signify the Administration's recognition of the increasing frequency of life settlement transactions.

Despite efforts by various state legislatures and insurance companies to restrict perceived abuses in life settlements, practitioners must be alert to those circumstances where the value of a policy held by their clients can be maximized by a life settlement transaction, as opposed to merely surrendering the policy to the insurance carrier. In those circumstances, the tax issues discussed in Rev. Rul. 2009-13 and Rev. Rul. 2009-14 must enter into the practitioner's analysis of the best course of action for the client. ■