

**EXPERTS' FORUM**

LEGAL

BANK/FINANCIAL

ACCOUNTING

HUMAN RESOURCES

TECHNOLOGY

OPEN FORUM

VIEW ALL

**Accounting** | ARTICLE DETAIL

(05/27/09)

 [link](#)
 [email](#)
 [print](#)

## IRS Rules On Sale Of Life Insurance Policies

With the growing number of people facing the loss of cash flow due to unemployment, the seizing up of the credit markets and the shrinking of their investment portfolios many are turning to a little thought of asset to free up some much needed cash.

In past years the secondary life insurance market had evolved into a way for insurance contracts to be bought and sold much like any other investment vehicle seen on the traditional securities markets.

However the seizing up of credit markets have caused this secondary market to slow, but increasingly as policyholders deplete other easy cash sources they may turn to the sale of their life insurance policy or the surrender of the policy to the originator for the cash surrender value.

The IRS has issued new guidance specifically on the sale of life insurance contracts. Rev. Rul 2009-13, 2009-21 IRB, outline the extent and character of the gain that will be recognized. When a policy is surrendered to the originator for the cash surrender value a taxable event has occurred and the proper accounting of that transaction is necessary.

Generally the cash surrender value (CSV) of the contract will exceed the amount that has been spent to maintain the contract. Just like any transaction where a realized gain must be determined it is necessary to have the amount received and the basis of the item given up. In this case the consideration received is the CSV (less any fees by the insurance company) and the basis in the contract is the investment in the contract.

The investment in the contract is the sum of premiums paid plus any other consideration paid less any amount received under the contract that is excludable from gross income (loans & distributions).

The gain realized calculation is relatively straightforward. The character of the gain is ordinary, although it would appear that capital treatment should be awarded, §61(a)(10) specifically states that gain from surrender or maturity must be included in ordinary income. Life insurance that is sold to a third party also constitutes a taxable event and can create both ordinary income and long term capital gain.

The determination that needs to be made first is the basis of the contract. Normally this would be easily be determined to be the premiums paid for the policy, but since life insurance contracts are inherently dual purpose (insurance and investment) a portion of each premium paid is insurance coverage that is not actually an investment and will not be considered basis.

So the basis in a contract will be the total premiums paid (plus other consideration paid) less the portion applicable to the insurance coverage. This amount will be the basis used to determine the gain from the sale. The overall gain then may have both capital and ordinary characteristics. The gain that would have been recognized had the policy been surrendered will remain as ordinary income with the remainder of the gain recognized as capital gain.



**DAVID BRAUER**  
 Tax Partner  
 Lurie Besikof Lapidus  
[dbrauer@lblco.com](mailto:dbrauer@lblco.com)  
[www.lblco.com](http://www.lblco.com)

**RECENT ENTRIES**

Managing Talent Through Tough Times  
**KIM E. RUYLE, PHD**  
 Vice President, Product Development  
 Korn/Ferry Leadership and Talent Consulting 07/23/09

Time For A Deferred Compensation Plan?  
**DAVID BRAUER**  
 Tax Partner  
 Lurie Besikof Lapidus 07/22/09

Cracking the credit code – credibility, character, capacity, capital, collateral & conditions.

**STEVE TORNIO**  
 Senior Vice President / Market President  
 MINNWEST Bank 07/21/09

“Collision at the Crossroads – Corporate interests and social media are colliding. Will the airbags deploy?”

**RIFF YEAGER**  
 Managing Director of Exponent  
 Colle+McVoy 07/20/09