



## BUSINESS PLANNING

Transfers for Value

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### TRANSFERS FOR VALUE

## SUMMARY

### WHAT IS A "TRANSFER FOR VALUE"?

Under Section 101 of the Internal Revenue Code, most life insurance death benefits are received free of federal income tax. But, if a policy has been sold or otherwise transferred for valuable consideration, the portion of the death benefit that exceeds the policy's cost basis may be taxable as ordinary income.

A "transfer for value" occurs when an owner transfers a life insurance policy in exchange for something of value, unless the transfer falls into an exempt class. However, an actual sale isn't necessary, because even a promise or agreement providing for a right to receive the policy proceeds in exchange for value can result in a transfer for value.

### WHAT ARE SOME EXAMPLES?

The most common transfer-for-value problems arise in business insurance situations involving key employee or buy-sell policies. Also, special rules apply when pensions are involved.

The simplest example of a transfer for value is the sale of the policy for its cash value to a transferee who is not exempt. However, if a policy is transferred without any cash changing hands and the policy is subject to a loan that exceeds its cost basis, a transfer for value has occurred.

If the policyowner agrees to name a third party as beneficiary of all or part of the death proceeds for valuable consideration, a transfer for value occurs even though no actual assignment of the policy has taken place.



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#### WHICH TRANSFERS ARE EXEMPT?

Certain categories of transferees can purchase a life insurance policy without triggering a transfer for value. These exempt transferees are:

1. The insured
2. The spouse of the insured individual (if the policy is purchased directly from the insured)
3. A partner of the insured
4. A partnership in which the insured is a partner
5. A corporation in which the insured is a shareholder or an officer

Also, a gift of a policy is generally not a transfer for value, since it is considered a gratuitous transfer motivated by detached and disinterested generosity. If the death proceeds would have been exempt to the gift donor, they will be exempt to the donee. However, if the gifted policy has a loan against it that exceeds the donor's basis, this creates a transfer for value.

If the policyowner exchanges anything of value for the policy, a transfer for value will occur unless the transferee is in one of the exempt categories.

#### ARE LIFE INSURANCE DEATH BENEFITS TAXABLE IN OTHER SITUATIONS?

Life insurance death benefits may also be taxable if:

- ◆ Proceeds include the cash value portion of a policy held in a qualified retirement plan
- ◆ Proceeds are received through a corporation as compensation or dividends
- ◆ Proceeds are received by a creditor on the life of a debtor
- ◆ There was no insurable interest in the life of the insured
- ◆ In some cases, if an employer did not obtain written consent from an employee after providing notice of an intent to insure the employee
- ◆ Proceeds are received as part of a "reportable policy sale"



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#### HOW CAN POLICYOWNERS AVOID PROBLEMS WITH TRANSFERS?

Since transferring ownership of a life insurance policy can raise questions concerning the income tax status of the policy's death benefit, it's important to take care when identifying the transferee and determining under what circumstances the transfer is to be made.

