

TAX CUTS AND JOBS ACT OF 2017

TRANSFER FOR VALUE RULE IMPACT ON BOLI PROPOSED, CORRECTIVE IRS & TREASURY GUIDANCE

Update and Potential Correction:

On March 22, 2019, the Internal Revenue Service and the Treasury Department issued proposed regulations that potentially provides the needed clarity regarding circumstances in which bank owned life insurance policies are transferred as part of a bank merger or acquisition.¹ In general, the guidance provides that tax-free transfers of policies between C corporations that do not have more than 50 percent of their assets in BOLI policies are not subject to the new reporting and income inclusion rules. This is an important exception and very good news.

The American Bankers Association, AALU, Federal Policy Group and BFS-MC Group have all welcomed this guidance as it is very clear from the proposed regulations that our concerns were taken into account by Treasury and the IRS. The Preamble of the regulation notes the following, for example:

Comments received on Notice 2018-41² suggested that acquisitions of life insurance contracts, or interests therein, in certain ordinary course business transactions involving the acquisition of a trade or business should not be considered reportable policy sales, including ordinary course business transactions whereby one trade or business acquires another trade or business that owns life insurance on the lives of former employees or directors. The definition of substantial business relationship in §1.101-1(d)(2) of the proposed regulations, as well as certain other provisions in the proposed regulations, are intended to exclude certain of these transactions from the definition of reportable policy sales.

The proposed regulations also provide specific exceptions to the definition of a reportable policy sale, which reinstates allowable, non-reportable sale/transfers of life insurance contracts between related entities. This is important for transfers related life insurance trusts, bank to bank holding company, etc. As noted in the Preamble:

The proposed regulations also provide several exceptions from the definition of reportable policy sale. The proposed regulations provide that the transfer of an interest in a life insurance contract between certain related entities is not a reportable policy sale. Specifically, a transfer between entities with the same beneficial owners is not a reportable policy sale if the ownership interest of each beneficial owner in each entity does not vary by more than a 20 percent ownership interest. See §1.101-1(c)(2)(i) and (g)(10) of the proposed regulations. Also, a transfer between corporations that are members of an affiliated group (as defined in section 1504(a)) that files a consolidated U.S. tax return for the taxable year in which the transfer occurs is not a reportable policy sale. See §1.101-1(c)(2)(ii) of the proposed regulations.

With respect to the effective date of the relevant proposed regulations, the rules state that they are generally applicable with respect to reportable policy sales made after December 31, 2017, and for all other purposes to transfers made after the date the proposed regulations are published in final form in the federal register.

¹ <https://www.federalregister.gov/d/2019-05400>

² <https://www.irs.gov/pub/irs-drop/n-18-41.pdf>

The proposed regulations are open for comment until Thursday, May 9, 2019 (i.e., the date which is 45 days after March 25, 2019, the date the proposed regulations are scheduled to be published). During this time, analysis of the proposed regulation will continue and BFS-MC will be sure to advise on any changes in guidance or timing of issuance.

Background:

The Tax Cuts and Jobs Act of 2017 (Pub.L. 115-97)³ modified the Transfer for Value (TVF) exception for life insurance contracts (including Employer Owned Life Insurance) for transactions after 12/31/2017. This was an inadvertent consequence that impacted COLI and BOLI that was acquired via merger and acquisition activity.

Under 101(a)(1)⁴, death proceeds paid under an insurance contract are generally excluded from gross income. Under 101(a)(2), limitations and exceptions to those limitations are outlined for cases when a policy has been transferred for “valuable consideration.” Under 101(a)(3), death proceeds are only *partially* excludable from gross income for any commercial transfer of a life insurance contract considered a “reportable policy sale.”

Under 101(a)(3)(B), “reportable policy sale” means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer’s interest in such life insurance contract. For purposes of the preceding sentence and BOLI, the term “indirectly” applies to the acquisition of another bank that holds owns BOLI. Also, with respect to “financial relationship” it remained unclear if nonqualified benefit plans and/or death benefit sharing arrangements (i.e. split dollar plans) substantiated a “financial relationship” and could be excluded from the gross income calculation.

With the high volume of bank M&A activity, that continues to pick up across the country, there have been a number of indirect “reportable policy sales” that negatively impacted acquired BOLI portfolios and require reporting under Section 6050Y⁵. While the scope of applicability and impact was limited to the inactive insured population of acquired BOLI portfolios, many institutions have surrendered acquired BOLI holdings, established and maintain deferred tax liabilities, or, at a minimum, been concern that tax benefits associated with the receipt of proceeds from transferred BOLI policies may not be eligible for exclusion from income with little guidance, clarity or consistently on how it should be handled.

³ <https://www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf>

⁴ <https://www.law.cornell.edu/uscode/text/26/101>

⁵ <https://www.law.cornell.edu/uscode/text/26/6050Y>