

Paperwork Initiative: IRS Notice 2018-41 Previews of Life Settlement Reporting Rules

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Wernher von Braun, the rocket scientist, famously said, “We can lick gravity, but sometimes the paperwork is overwhelming.” Financial concerns engaged in the life settlement business—that is, the buying and selling of life insurance policies in secondary and tertiary market transactions—can appreciate this concern. It’s a business that is burdened by paperwork. And that burden has recently increased. The US 2017 tax reform legislation, commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”),² added Section 6050Y to the Internal Revenue Code of 1986, as amended (the “Code”). Code § 6050Y imposes new tax information reporting requirements on certain parties when a person acquires a direct or indirect interest in a life insurance contract and has no substantial family, business or financial relationship with the insured (other than having purchased the insurance policy). On April 26, 2018, the Internal Revenue Service (“IRS”) released Notice 2018-41, providing taxpayers with a preview of proposed regulations it intends to issue under the new Code section. Importantly, the Notice states that no reporting will be required under Code § 6050Y until final regulations are published in the Federal Register, although certain policy sales and payments of certain death benefits occurring in 2018 and onward will still ultimately require reporting.

Background on Code § 6050Y

Code § 6050Y imposes reporting requirements on a number of parties involved in the acquisition of a life insurance contract from a policyholder.

First, Code § 6050Y states that every person who acquires a life insurance policy contract, or any interest in a life insurance contract, in a “reportable policy sale” in 2018 or after must report certain information to the IRS, including (i) the acquirer’s name, address and taxpayer identification number (“TIN”); (ii) the name, address, and TIN of each recipient of payment in the reportable policy sale; (iii) the date of the acquisition; (iv) the name of the issuer of the life insurance contract and the policy number on such contract; and (v) the purchase price. A “reportable policy sale” is 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.”

In addition to reporting this information to the IRS, the acquirer must furnish written statements to each payment recipient and the issuer named in the information return. The information statement furnished to the payment recipients must include all of (i)-(v) above, while the statement provided to the issuer must only

include (i)-(iv) above (i.e., the purchaser need not show the price it paid to the insurance carrier).

Second, if the issuer of a life insurance contract receives an information statement from the acquirer, or notice of a transfer of a life insurance contract to a non-US person, Code § 6050Y also imposes reporting requirements on such issuer. The issuer must also file a return with the IRS setting forth (x) the name, address and TIN of the seller who transferred any interest in the life insurance contract and (y) the seller's investment in the contract³ and (z) the policy number of the contract. In addition to filing a return with the IRS, the issuer must furnish a statement to the seller of the life insurance contract setting forth (i)-(iii) above, as well as the name, address and phone number of the issuer's information contact.

Finally, Code § 6050Y imposes reporting requirement on any person who makes a payment of "reportable death benefits" during any taxable year, defined to mean amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale. The payor must file a return with the IRS setting forth (i) the payor's name, address and TIN; (ii) the name, address and TIN of each recipient of such payment; (iii) the date of each such payment; (iv) the gross amount of each such payment; and (v) the payor's estimate of the buyer's investment in the contract. In addition, the payor must furnish each recipient of a payment a written statement that includes (i)-(v) above, as well as the name, address and phone number of the issuer's information contact.

Notice 2018-41

The Notice announces that the US Treasury and IRS intend to propose regulations generally implementing Code § 6050Y. This includes guidance with respect to (i) reporting by the acquirer, (ii) reporting by the issuer,

(iii) reporting by the payor of reportable death benefits and (iv) the timing of reporting under (i)-(iii) above. It is clear that the IRS expects to receive substantial input from affected life settlement market participants.

ACQUIRER REPORTING

First, with respect to the acquirer, Notice 2018-41 states the information reporting required by Code § 6050Y must be made according to forms and instructions to be published by the IRS. The IRS plans to define "acquirer" in the proposed regulations to be any person who directly or indirectly acquires an interest in a life insurance contract, and who has no substantial family, business or financial relationship with the insured apart from the acquisition of the life insurance contract. An indirect acquisition will be considered to occur when a person acquires an interest in a partnership, trust or other entity that holds a life insurance contract. It appears that the acquisition of an interest in a corporation that holds life insurance contracts could be subject to these rules. These rules have the potential for being the most problematic.

There is no requirement that the acquisition be from the insured, so tertiary market transactions will be subject to reporting as well. It makes sense that there be buyer-seller reporting in tertiary market transactions, so that the IRS can ensure that such transactions are properly reported for federal income tax purposes. However, issuer reporting for these transactions makes little sense as the information to be provided by the insurance carrier will not have relevance to tertiary market participants. Notice 2018-41 invites comments on the application of the reporting rules to such transactions.

These rules, as presaged, have the potential to require reporting any time an investor acquires an interest in a life settlement fund, even when the investor is acquiring a *de minimis* interest in the fund. Such reporting could be daunting for an investor given that information on every

policy held by the fund would have to be included in the filing and the contribution would have to be allocated to each policy held by the fund (presumably by the fund itself). The IRS has stated that it “may further refine” the definition of “indirectly.” Clearly, the IRS does not expect reporting any time a person acquires an interest in a corporation or publicly-traded partnership that holds a life insurance contract. Hopefully, the proposed and final regulations will fix this overbroad reach and provide a carve-out for acquisitions of small interests, interests in entities that themselves have reported policy acquisitions or both. The Notice states the proposed regulations may further refine the definition of “acquirer,” for example, by including life settlement providers or viatical settlement providers as an acquirer.

It is also common in life settlement transactions for the beneficial interest in a life policy first to be acquired by a broker (sometimes through a trust) and for the beneficial interest to then be immediately transferred to the ultimate buyer. Under the Notice, both of these transactions would be subject to the full array of purchaser reporting and issuer reporting. Notice 2018-41 invites comments on whether transactions with these characteristics should be aggregated for reporting purposes or subject to a unified filing procedure. It would make sense in these transactions to ignore the broker as an acquirer.

In those instances in which there is more than a single acquirer of a life insurance contract, it appears that each acquirer would have a reporting requirement and the issuer could have multiple reporting requirements on the same transaction. The IRS has invited comments on whether an aggregate filing would be appropriate in these circumstances. Unless partnerships are treated as aggregates for this purpose (instead of entities), this situation would be extremely rare and should not receive disproportionate attention from the IRS.

REPORTABLE PAYMENTS

Notice 2018-41 states that the IRS intends to clarify that the definition of “reportable payment” may include payments to persons other than the seller, such as brokers, and potentially life settlement providers acting as intermediaries. The Notice states that proposed regulations will clarify that the “payment” to the seller required to be reported under Code § 6050Y is the seller’s net proceeds (equal to the seller’s gross proceeds less any selling expenses, such as broker’s fees and commissions). Sales of insurance contracts to non-US persons will be subject to the same information reporting as sales to domestic persons.

INSURANCE COMPANY REPORTING

Notice 2018-41 provides some guidance for policy issuers required to report under Code § 6050Y. The Notice states that proposed regulations will limit the information reporting obligations imposed on the life insurance company responsible for administering a contract. Specifically, the IRS intends the proposed regulations to exempt from the definition of “issuer” reinsurers in an indemnity contract covering all or a portion of the risks that the original issuer might otherwise have incurred with respect to a life insurance contract. Further, as discussed above, an issuer must report to the IRS a seller’s “investment in the contract,” but the Notice states this obligation will be limited to information known to the issuer. Also, in addition to the requirements imposed on issuers set forth above, the Notice states that proposed regulations will require an issuer to report to the IRS the amount that would have been received by the policyholder upon surrender of the contract. Finally, as with acquirers, the Notice states that issuers required to file information returns must do so on forms and instructions published by the IRS.

The insurance company must also report information to the seller, who needn't be the insured. As a result, tertiary transactions—that is, transactions in which the seller is a secondary market participant—will also be subject to insurance company reporting.

For payors of reportable death benefits, similar to the guidance on reporting required by acquirers and issuers, reporting is to be made on information returns according to forms and instructions published by the IRS. As discussed above, a payor must report to the IRS an estimate of the buyer's investment in the contract, which the Notice states will be defined as the premiums paid by the buyer under the contract less the aggregate amount received by the buyer under the contract.

REPORTING TIMING

In addition, Notice 2018-41 provides a preview of the timing for the reporting obligations discussed above, as envisioned by the IRS. According to the Notice, the proposed regulations are intended to state that all information returns discussed above required to be filed with the IRS must be filed no later than February 28 for paper returns (March 31 for electronic returns) of the year following the calendar year in which the reportable policy sale or payment of the reportable death benefit occurs. The IRS intends the proposed regulations to require an acquirer to furnish the required information statements to the issuer by the later of (1) 20 days after the reportable policy sale, or (2) 5 days after the end of the applicable state late-rescission period, if any, but in no event later than January 15 of the year following the calendar year in which the policy sale occurs. All other written statements other than the information provided by the acquirer to the issuer (i.e., reporting under Code § 6050Y required to be made to any party other than the IRS) must be furnished to the applicable

recipients no later than January 31 of the year following the calendar year in which the reportable policy sale or reportable death benefit payment occurs. This means, for example, that if an issuer receives an information statement from an acquirer on January 15, the issuer may only have the rest of that month to fulfill its information reporting requirements to the seller of the life insurance contract. Systems build-outs will have to be undertaken quickly.

Looking Forward

New Code § 6050Y requires reporting for reportable policy sales and payments of reportable death benefits occurring after December 31, 2017. However, as discussed above, the Notice states that no reporting will be required under Code § 6050Y until final regulations are published in the Federal Register. For sales and payments occurring after December 31, 2017, and before final regulations are published in the Federal Register, the Notice states that the Treasury and the IRS intend to allow additional time after the date on which the final regulations are published for applicable taxpayers to file the returns and furnish the written statements discussed above. Therefore, taxpayers should keep track of any reportable policy sales and payments of reportable death benefits in 2018. Although no reporting will be required on such sales or payments before final regulations are published, such sales and payments will ultimately require reporting.

The Notice also requests comments on a number of specific points, including the application of the rules to tertiary transactions and whether prearranged transfer should be treated as a single transaction or as multiple transactions. Any comments must be submitted by June 13, 2018.

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- 2 Pub. L. 115-97, 131 Stat. 2054 (2017). For an overview of the Tax Act's main provisions, please see "[The Good, the Bad and the Ugly—Fundamental Tax Reform Is Enacted Into Law.](#)"
- 3 Defined under Code § 72(e)(6) on any date as the aggregate amount of premiums or other consideration paid for that contract before that date, less the aggregate amount received under the contract before that date to the extent that amount was excludable from gross income.

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