



DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-108054-21]

RIN 1545-BQ07

Information Reporting and Transfer for Valuable Consideration Rules for Section 1035 Exchanges of Life Insurance and Certain Other Life Insurance Contract Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing guidance on the application of the transfer for valuable consideration rules and associated information reporting requirements for reportable policy sales of interests in life insurance contracts to exchanges of life insurance contracts qualifying for nonrecognition of gain or loss, as well as to certain acquisitions of interests in life insurance contracts in transactions that qualify as corporate reorganizations. The proposed regulations affect parties involved in these life insurance contract transactions, including with respect to payments of reportable death benefits. This document also invites comments on these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 60 DAYS AFTER THE DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. Requests for a public hearing must be submitted as prescribed in the “Comments and Requests for a Public Hearing” section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at

www.regulations.gov (indicate IRS and REG-108054-21) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:LPD:PR (REG-108054-21), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Kathryn M. Sneade, (202) 317-6995 (not a toll-free number); concerning submissions of comments or requests for a public hearing, Vivian Hayes, (202) 317-6902 (not a toll-free number) or by email to *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 101 and 6050Y of the Internal Revenue Code (Code). The proposed regulations under sections 101 and 6050Y (proposed regulations) would provide guidance on the application of the rules for determining the amount of death benefits excluded from gross income following reportable policy sales of interests in life insurance contracts under section 101 and the associated information reporting requirements for reportable policy sales under section 6050Y to the exchange of a life insurance contract for another life insurance contract qualifying for nonrecognition of gain or loss under section 1035 (section 1035 exchange), as well as to certain acquisitions of interests in life insurance contracts in transactions that qualify as reorganizations under section 368(a) (reorganizations). The proposed regulations would amend final regulations under sections 101 and 6050Y (T.D. 9879) published in the **Federal Register** (84 FR 58460) on October 31, 2019, as corrected (84 FR 68042) on

December 13, 2019 (final regulations). Following the publication of the final regulations in the **Federal Register**, the Treasury Department and the IRS received letters relating to the application of sections 101 and 6050Y to section 1035 exchanges and reorganizations. The proposed regulations would modify the final regulations to address the issues raised in these letters.

Development of the Final Regulations

The Treasury Department and the IRS published the final regulations to implement legislative changes to the Code made by sections 13520 and 13522 of Public Law 115-97, 131 Stat. 2054, 2148, 2151 (2017), commonly known as the Tax Cuts and Jobs Act (TCJA).

Section 13522 of the TCJA amended section 101 by adding new section 101(a)(3) to the Code, which defines the term “reportable policy sale” and provides rules for determining the amount of death benefits excluded from gross income following a reportable policy sale.¹ The final regulations under section 101 provide definitions applicable under sections 101 and 6050Y and guidance for determining the amount of death benefits excluded from gross income. For example, §1.101-1(c)(1) of the final regulations defines “reportable policy sale” to mean, subject to certain exceptions, any direct or indirect acquisition of an interest in a life insurance contract if the acquirer has, at the time of the acquisition, no substantial family, business, or financial relationship

¹ Generally, under section 101(a)(1), gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract if such amounts are paid by reason of the death of the insured. However, the first sentence of section 101(a)(2) (the transfer for value rule) provides that, in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by section 101(a)(1) cannot exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee. The second sentence of section 101(a)(2) provides that the transfer for value rule does not apply in the case of transfers described in section 101(a)(2)(A) or (B). Section 101(a)(2)(A) (the carryover basis exception) applies if the contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor. Section 101(a)(2)(B) applies if the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer. However, section 101(a)(3)(A) provides that the exceptions in the second sentence of section 101(a)(2) do not apply in the case of a transfer of a life insurance contract, or any interest therein, that is a reportable policy sale.

with the insured apart from the acquirer's interest in the life insurance contract.

Section 13520 of the TCJA added section 6050Y to chapter 61 (Information and Returns) in subtitle F of the Code. Section 6050Y(a) requires a person who acquires a life insurance contract or any interest in a life insurance contract in a reportable policy sale to report certain information about payments made in the sale. Section 6050Y(b) requires issuers of life insurance contracts to report certain information upon notice of a reportable policy sale or a transfer of a life insurance contract to a foreign person. Section 6050Y(c) requires a payor of reportable death benefits (defined by section 6050Y(d)(4) as amounts paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale) to report certain information about such payments. Section 6050Y provides that each of the returns required by section 6050Y is to be made “at such time and in such manner as the Secretary shall prescribe.”² The final regulations under section 6050Y implement section 6050Y by specifying the manner in which and time at which the information reporting obligations imposed by section 6050Y must be satisfied. The final regulations also provide definitions and rules that govern the application of the information reporting obligations.

The final regulations were adopted after consideration of public comments received on proposed regulations under sections 101 and 6050Y (REG-103083-18) published in the **Federal Register** (84 FR 11009) on March 25, 2019 (2019 proposed regulations), and a public hearing held on June 5, 2019. Additionally, the Treasury Department and the IRS received comments in response to Notice 2018-41, 2018-20 I.R.B. 584, which described the regulations the Treasury Department and the IRS expected to propose under sections 101 and 6050Y, and considered these comments in

² Section 7701(a)(11)(B) provides that when used in the Code, the term “Secretary” means the Secretary of the Treasury or her delegate.

developing the rules in the 2019 proposed regulations.

Development of the Section 1035 Exchange Provisions of the Final Regulations

Prior to amendment in 2019, the regulations under section 101 did not explicitly address section 1035 exchanges. Comments received on Notice 2018-41 suggested that the person to whom a life insurance contract is issued (that is, the original policyholder) should not be considered an “acquirer” for purposes of section 6050Y(a), which imposes reporting obligations on any person who acquires a life insurance contract or any interest in a life insurance contract in a reportable policy sale. See 84 FR 11009, 11016. In response, §1.101-1(e)(2) of the 2019 proposed regulations clarified that the issuance of a life insurance contract to a policyholder, other than the issuance of a policy in an exchange pursuant to section 1035, is not a transfer of an interest in a life insurance contract.

The preamble to the 2019 proposed regulations requested comments on whether the regulations should include additional provisions regarding the treatment of section 1035 exchanges of life insurance contracts. See 84 FR 11009, 11019. As described in the preamble to the final regulations, one commenter on the 2019 proposed regulations recommended that no additional provisions be added to the regulations for this circumstance, stating that the acquirer of a life insurance contract in a reportable policy sale would be unlikely to meet the state law requirements for an insurable interest in the insured and, consequently, would not be able to make a section 1035 exchange. See 84 FR 58460, 58465. Another commenter recommended that the statement in §1.101-1(e)(2) of the 2019 proposed regulations regarding section 1035 exchanges be deleted or amended to eliminate any suggestion that such transactions, by themselves, can be reportable policy sales. The commenter acknowledged that in a section 1035 exchange, the new carrier acquires an interest in the old policy, but advocated against treating that acquisition as a reportable policy sale.

As explained in the preamble to the final regulations, the reference in §1.101-1(e)(2) to section 1035 exchanges was not intended to imply that the transfer of a policy to an insurance company in a section 1035 exchange would be a reportable policy sale. See 84 FR 58460, 58465. Rather, the concern prompting the reference to section 1035 exchanges related to the possibility that a policy transferred in a reportable policy sale subsequently could be exchanged for a new policy in an exchange pursuant to section 1035 and that, absent the reference in §1.101-1(e)(2), the death benefits paid under the new policy might not be reported under section 6050Y(c).

Section 1.101-1(e)(2) of the 2019 proposed regulations was adopted as proposed in the final regulations, but in response to the comments received on section 1035 exchanges, §1.101-1(c)(2)(iv) of the final regulations provides that the acquisition of a life insurance contract by an insurance company in an exchange pursuant to section 1035 is not a reportable policy sale. Additionally, §1.101-1(c)(2)(v) of the final regulations provides that the acquisition of a life insurance contract by a policyholder in an exchange pursuant to section 1035 is not a reportable policy sale if the policyholder has a substantial family, business, or financial relationship with the insured, apart from its interest in the life insurance contract, at the time of the exchange. Based on a comment received on the 2019 proposed regulations, a situation in which the policyholder making a section 1035 exchange does not have a substantial family, business, or financial relationship with the insured should rarely arise due to state law insurable interest requirements. Should this situation arise, however, the final regulations provide certain exceptions to the reporting requirements that generally apply to reportable policy sales. See §1.6050Y-2(f)(3) of the final regulations (providing that, with respect to the issuance of a life insurance contract in a section 1035 exchange, the acquirer is not required to file the information return required by section 6050Y(a)(1) and §1.6050Y-2(a) of the final regulations); §1.6050Y-3(f)(3) of the final regulations

(providing that the issuer of a new life insurance contract in a section 1035 exchange is not required to file a return or furnish a statement to the seller under section 6050Y(b) and §1.6050Y-3 of the final regulations). Additionally, the final regulations provide certain rules applicable to section 1035 exchanges to clarify the reporting required with respect to section 1035 exchanges that are reportable policy sales. See §1.6050Y-1(a)(8)(ii) (providing that, in the case of the issuance of a life insurance contract to a policyholder in an exchange pursuant to section 1035, the issuer of the new contract is the 6050Y(a) issuer with respect to whom the acquirer has reporting obligations under section 6050Y(a) and §1.6050Y-2 of the final regulations).

Letters Received on the Section 1035 Exchange Provisions of the Final Regulations

Following the publication of the final regulations in the **Federal Register**, the Treasury Department and the IRS received letters relating to the application of sections 101 and 6050Y to section 1035 exchanges under the final regulations.

One letter indicated that, in at least some cases, the final regulations under section 101 regarding reportable policy sales appear to treat a section 1035 exchange as a transfer for value that can cause the death benefits to become taxable. The letter said that this treatment appears to arise even when neither the contract given in the exchange nor any predecessor contract has been involved in a reportable policy sale. The author of the letter requested guidance that the issuance of a life insurance contract in a section 1035 exchange is not a transfer of an interest in the contract to the owner for purposes of the transfer for value rule and provided support for the position that treating a section 1035 exchange as a transfer for value is inconsistent with the relevant statutes, congressional intent, sound tax policy, and long-standing interpretations of the law.

The author of another letter took a contrary position, stating that a section 1035 exchange has always (before the TCJA was enacted, as well as after) constituted a

transfer of a life insurance contract for purposes of section 101(a)(2) that qualifies for the exception set forth in section 101(a)(2)(A) to the transfer for value rule for contracts held with a transferred basis, commonly referred to as the “carryover basis” exception. This author advocated against guidance concluding that the issuance of a life insurance contract in a section 1035 exchange is not a transfer of an interest in the contract to the owner for purposes of the transfer for value rule, suggesting that to do so would be to adopt a policy choice that was specifically rejected by Congress with the enactment of section 101(j).³ The author remarked that section 101(j) was enacted in response to concerns that despite state insurable interest rules, companies were acquiring insurance on persons whose relationship with the company was too attenuated and were doing so without the consent (or even knowledge) of such persons.

Development of Exceptions Related to Ordinary Course Trade or Business Acquisitions in the Final Regulations

Several commenters on Notice 2018-41 suggested that acquisitions of life insurance contracts, or interests therein, in ordinary course business transactions in which one trade or business acquires another trade or business that owns life insurance on the lives of former employees or directors should not be reportable policy sales. The 2019 proposed regulations included provisions that exclude certain of these transactions from the definition of reportable policy sales. Public comments remarked favorably on these provisions, which were adopted by the final regulations. See §1.101-1(d)(2) of the final regulations (defining the term “substantial business relationship” to include the relationship between an insured and an acquirer in certain circumstances

³ Section 101(j) generally provides that in the case of an employer-owned life insurance contract, the amount of death benefits excluded from gross income under section 101(a) is limited, unless certain notice and consent requirements are met and either an exception based on the insured’s status applies (because the insured was an employee in the twelve months preceding death or the insured was, at the time the life insurance contract was issued, a director, highly compensated employee, or highly compensated individual) or an exception for amounts paid to the insured’s heirs applies.

involving the acquirer's acquisition of an active trade or business with respect to which the insured is an employee within the meaning of section 101(j)(5)⁴ or was a director, highly compensated employee, or highly compensated individual); §1.101-1(d)(4)(i) of the final regulations (providing a special rule for indirect acquisitions that deems the acquirer of an interest in a life insurance contract to have a substantial business or financial relationship with the insured if the direct holder of the interest in the life insurance contract has such a relationship); and §1.101-1(e)(3)(ii) of the final regulations (defining the term “indirect acquisition of an interest in a life insurance contract” to exclude an acquisition through ownership of stock in a C corporation provided that no more than 50 percent of the gross value of the assets of the C corporation consists of life insurance contracts).

As described in the preamble to the final regulations, one commenter on the 2019 proposed regulations remarked that §1.101-1(e)(3)(ii) results in the disparate treatment of policies transferred directly in asset reorganizations and indirectly in stock reorganizations. See 84 FR 58460, 58466-58468. That is, with respect to policies held by a C corporation, not more than 50 percent of the gross value of the assets of which consists of life insurance contracts, an indirect acquisition of the policies, such as through a stock reorganization under section 368(a)(1)(B), would not result in a reportable policy sale, but a direct acquisition of the policies, such as through an asset reorganization under section 368(a)(1)(A), could result in a reportable policy sale. The commenter asserted that this disparate treatment is inappropriate and not warranted as a matter of good tax policy and requested that the 2019 proposed regulations be revised to provide that any transfer of an interest in a life insurance contract as part of a reorganization of a C corporation conducted in the ordinary course of business is

⁴ Section 101(j)(5) defines the term “employee” to include an officer, director, and highly compensated employee (within the meaning of section 414(q)).

eligible for an exception to being treated as a reportable policy sale under section 101(a)(3)(B), regardless of whether the target C corporation survives the reorganization transaction unless, immediately prior to the acquisition, more than 50 percent of the gross value of the assets of the C corporation consists of life insurance contracts.

The commenter acknowledged that the 2019 proposed regulations provide certain exceptions that could apply to mergers qualifying as reorganizations in which the target goes out of existence and the surviving corporation continues to hold the life insurance contract, but asserted that having to determine in these types of mergers whether a particular exception applies on a contract-by-contract basis is unduly complex and a trap for the unwary. The commenter further asserted that this burdensome exercise does not serve the purpose of the change in the statute.

The commenter's recommendation was not adopted in the final regulations for reasons further described in the preamble to the final regulations. Briefly, the final regulations preserve the different results for stock and asset reorganizations because the Treasury Department and the IRS concluded that significant differences between the two types of reorganization justify different treatment for purposes of sections 101 and 6050Y. For instance, an acquirer of an interest in an entity may have limited ability to determine what types of assets an entity owns, or to obtain from the entity information necessary to report on the entity's assets. Further, the Treasury Department and the IRS had not identified any clear policy reason why the complete exclusion of death benefits from policies held by a corporation should carry over when ownership of the insurance policy is transferred but a substantial business or financial relationship does not exist between the acquirer and insured. Regarding the commenter's remark on the burden of a case-by-case review of policies in certain types of transactions, the preamble to the final regulations noted that, in asset reorganizations, it would in any case be necessary to review the life insurance contracts directly acquired on a contract-

by-contract basis in order to update insurance contract ownership and beneficiary information with the relevant insurance company.

Letter Received on Exceptions Related to Ordinary Course Trade or Business

Acquisitions in the Final Regulations

Following the publication of the final regulations in the **Federal Register**, the Treasury Department and the IRS received a letter relating to the disparate treatment of different types of ordinary course trade or business acquisitions under the final regulations.

The author noted that, since the issuance of the final regulations, the life insurance industry has seen a number of circumstances in which transactions that are wholly unrelated to the transfer of life insurance are nevertheless subject to negative outcomes under the reportable policy sale rules as a result of the transactions' legal form, even though transactions with identical or nearly identical economic substance but a different legal form would be treated more favorably. The author noted that the ordinary course acquisitive transactions of concern do not in any way turn on tax outcomes pertaining to the meagre amounts of life insurance that are commonly at issue, and asserted that there are a number of legal, economic, and business practice reasons why it is highly unlikely that these same transactions can simply be restructured to meet the form-driven rules of the final regulations. The author suggested the addition of an exception from the reportable policy sale rules for acquisitive transactions involving entities that own a *de minimis* amount of life insurance (for example, as a proportion of the total value of the transaction). More specifically, the author proposed that the Treasury Department and the IRS consider a further exception for transactions in which the amount of life insurance acquired as a result of the acquisitive transaction (and any related acquisitions) is five percent or less of the value of the stock, assets, or both acquired.

Explanation of Provisions

Section 1035 Exchanges

As stated in the preamble to the final regulations, the concern prompting the references to section 1035 exchanges in the 2019 proposed regulations and the final regulations related to the possibility that a policy transferred in a reportable policy sale subsequently could be exchanged for a new policy in an exchange pursuant to section 1035 and that the death benefits paid under the new policy might not be reported under section 6050Y(c). See 84 FR 58460, 58465. The section 1035 exchange provisions were not intended to change the treatment under section 101 of the policyholder's new contract if the policyholder's old contract was never transferred in a reportable policy sale.

However, the Treasury Department and the IRS have determined that such a change was inadvertently effected by the final regulations. Prior to the issuance of the final regulations, the transfer for value rule of section 101(a)(2) did not apply as the result of a section 1035 exchange of a life insurance contract by the original policyholder of the contract. However, under §1.101-1(e)(2) of the final regulations, the issuance of a new policy in a section 1035 exchange is a transfer of an interest in a life insurance contract. Because the new policy is issued in exchange for an old policy, the exchange is a transfer for valuable consideration under §1.101-1(f)(5) of the final regulations. Therefore, the new policy is subject to the transfer for value rule of section 101(a)(2), unless one of the exceptions in section 101(a)(2)(A) and (B) applies. For either exception to apply, there must be a substantial business, family, or financial relationship between the insured and the acquirer of the new policy. The Treasury Department and the IRS have determined that the carryover basis exception of section

101(a)(2)(A) would not apply in this case.⁵ Therefore, the application of the transfer for value rule would generally limit the amount of death benefits excludable under section 101(a)(1), even in the absence of a reportable policy sale, unless one of the section 101(a)(2)(B) exceptions applies (that is, the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer). The Treasury Department and the IRS have determined that this result is inconsistent with the prior treatment of new policies issued in section 1035 exchanges.

Accordingly, the proposed regulations are intended to correct the unintended change effected by the final regulations to the treatment under section 101 of a life insurance contract issued to a policyholder in a section 1035 exchange, while continuing to address the concern that the reporting of death benefits paid under section 6050Y(c) could be avoided by exchanging a policy transferred in a reportable policy sale for a new policy in a section 1035 exchange, as well as the concern that a policyholder could attempt to avoid the limitation on the excludability of death benefits resulting from the application of the transfer for value rule through a section 1035 exchange. The proposed regulations would accomplish these objectives by revising the final regulations in four ways.

1. Modify definition of a transfer of an interest in a life insurance contract

⁵ The Code recognizes two categories of substituted basis property: transferred basis property and exchanged basis property. See section 7701(a)(42). Property has a “transferred basis” for Federal tax purposes when the same property is transferred from one person to another but keeps the same basis. See section 7701(a)(43). Property has an “exchanged basis” for Federal tax purposes when a person’s basis in new property is determined by reference to other property held by that same person. See section 7701(a)(44). The section 101(a)(2) “carryover basis” exception applies to a transfer if the transferred life insurance contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor. That is, the exception applies if the contract is transferred basis property. However, the basis of a new policy issued in a section 1035 exchange to the same taxpayer is the same as the basis of the old policy held by that taxpayer, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. See sections 1035(d)(2) and 1031(d). The new policy is thus exchanged basis property, not transferred basis property. It is therefore ineligible for the carryover basis exception of section 101(a)(2)(A).

First, proposed §1.101-1(e)(2) would revise the definition of a transfer of an interest in a life insurance contract in §1.101-1(e)(2) of the final regulations to exclude the issuance of a life insurance contract to a policyholder, without qualification. As such, any issuance of a life insurance contract to a policyholder, including in a section 1035 exchange, is not a transfer of an interest in a life insurance contract and therefore cannot be a reportable policy sale under §1.101-1(c)(1) of the final regulations. The Treasury Department and the IRS do not view this position as inconsistent with the purpose of section 101(j). See Public Law 109-280, §863(d), 120 Stat. 780, 1024 (2006) (providing that section 101(j) generally applies to life insurance contracts issued after August 17, 2006, “except for a contract issued after such date pursuant to an exchange described in section 1035...for a contract issued on or prior to that date”); Notice 2009-48, 2009-1 C.B. 1085 (providing that further notice and consent is not required by section 101(j) with regard to a contract received in a section 1035 exchange for an employer-owned life insurance contract issued after August 17, 2006, for which the notice and consent requirements were previously satisfied if either (1) the existing consent remains valid, or (2) the exchange does not result in a material change in the death benefit or other material change in the contract).

The proposed regulations make conforming changes to remove the exception in §1.101-1(c)(2)(v) of the final regulations (providing that the acquisition of a life insurance contract by a policyholder in a section 1035 exchange is not a reportable policy sale if the policyholder has a substantial family, business, or financial relationship with the insured, apart from its interest in the life insurance contract, at the time of the exchange); to remove §§1.6050Y-2(f)(3) and 1.6050Y-3(f)(3) of the final regulations (providing certain reporting requirement exceptions related to section 1035 exchanges that are no longer necessary); and to remove §1.6050Y-1(a)(8)(ii) of the final regulations (providing a definitional rule related to section 1035 exchanges that is no

longer necessary).

2. New rule addressing section 1035 exchanges

Second, proposed §1.101-1(b)(2)(iv) provides a new rule that would apply to the exchange of an interest in a life insurance contract (old interest) in a section 1035 exchange for an interest in a newly issued life insurance contract (new interest) and provides guidance on how to determine the amount of the proceeds attributable to the new interest that is excludable from gross income under section 101(a), provided the new interest is not subsequently transferred or exchanged. If the new interest is subsequently transferred or exchanged, the amount excludable from gross income under section 101(a) would be determined under the rule in §1.101-1(b) applicable to the type of transfer or exchange involved. The limitation (or lack of any limitation) on the amount of the proceeds attributable to the old interest that is excludable from gross income applies under proposed §1.101-1(b)(2)(iv) to the new interest for which it is exchanged, just as the basis of the old interest applies to the new interest. See sections 1031(d) and 1035(d)(2) (providing that a contract acquired in a section 1035 exchange has the same basis as the contract for which it was exchanged). The IRS has previously treated certain attributes of contracts exchanged in section 1035 exchanges as applying to the new contracts acquired. See, e.g., Rev. Rul. 92-95, 1992-2 C.B. 43 (for purposes of section 72(q)(2)(I) and 72(u)(4), the “date of purchase” of an annuity contract acquired in a section 1035 exchange for another annuity contract is the date of purchase of the annuity contract that was exchanged for the new contract). See also section 7702A(a)(2) (defining a modified endowment contract to include any contract exchanged for a contract that is a modified endowment contract under section 7702A(a)(1)).

Proposed §1.101-1(b)(2)(iv) ensures that the acquirer of an interest in a life insurance contract in a reportable policy sale cannot avoid any limit imposed by section

101(a)(2) and (a)(3) on the amount of the proceeds attributable to the interest that is excludable from gross income under section 101(a)(1) by simply exchanging the interest for a new life insurance contract. Under proposed §1.101-1(b)(2)(iv)(A), if the entire amount of the proceeds attributable to the old interest would have been excludable from gross income under section 101(a) at the time of the section 1035 exchange, the entire amount of the proceeds attributable to the new interest is excludable from gross income. Under proposed §1.101-1(b)(2)(iv)(B), if less than the entire amount of the proceeds attributable to the old interest would have been excludable from gross income under section 101(a) at the time of the section 1035 exchange, the amount of the proceeds attributable to the new interest that is excludable from gross income is limited to the sum of the amount of the proceeds attributable to the old interest that would have been excludable at the time of the section 1035 exchange, and the premiums and other amounts subsequently paid with respect to the new interest by the policyholder. Proposed §1.101-1(b)(2)(iv)(B) also provides that, when determining the premiums and other amounts subsequently paid by the policyholder with respect to the new interest, the amounts paid by the policyholder are reduced, but not below zero, by amounts received by the policyholder under the new life insurance contract that are not received as an annuity, to the extent excludable from gross income under section 72(e). The proposed regulations also make conforming changes to §1.101-1(a)(1) of the final regulations and the headings of §1.101-1(b) and (b)(2) of the final regulations to reflect the addition of proposed §1.101-1(b)(2)(iv). The proposed regulations also add two examples to illustrate the application of the rules set forth in proposed §1.101-1(b)(2)(iv). See proposed §1.101-1(g)(17) and (18).

3. Modification to definition of reportable policy sale

Third, the proposed regulations would modify the definition of “reportable policy sale” to address section 1035 exchanges. Specifically, proposed §1.101-1(c)(3)

addresses situations in which an old interest is exchanged in a section 1035 exchange for a new interest, and the old interest was previously transferred for valuable consideration in a reportable policy sale or is treated, under proposed §1.101-1(c)(3), as an interest in a life insurance contract that was previously transferred for valuable consideration in a reportable policy sale. In such cases, the new interest is treated, for purposes of §1.101-1, as an interest in a life insurance contract that was previously transferred for valuable consideration in a reportable policy sale.

Under the proposed rule, the old interest's attribute of having been previously transferred for valuable consideration in a reportable policy sale applies to the new interest acquired in a section 1035 exchange. Whether or not an interest in a life insurance policy was previously transferred in a reportable policy sale is relevant for the purpose of determining the applicability of certain provisions in the final regulations. See, e.g., §1.101-1(b)(1)(ii)(B)(1) of the final regulations (applies only if the interest was not previously transferred for valuable consideration in a reportable policy sale); §1.101-1(b)(1)(ii)(B)(2) and (3) of the final regulations (apply if the interest was previously transferred for valuable consideration in a reportable policy sale); §1.101-1(b)(2)(i) of the final regulations (includes a special rule for interests that have not previously been transferred for value in a reportable policy sale). The Treasury Department and the IRS have previously treated (and continue to treat) other attributes of contracts exchanged in section 1035 exchanges as applying to the new contracts acquired, so the new contract is treated the same as the old contract. See, e.g., Rev. Rul. 92-95. Similarly, the proposed rule ensures that the new interest is treated the same as the old interest when applying rules that consider whether an interest in a life insurance contract was previously transferred in a reportable policy sale. See proposed §1.101-1(c)(3).

Proposed §1.101-1(c)(3) also provides that, for purposes of §§1.6050Y-3 and 1.6050Y-4, the section 1035 exchange is treated as the transfer of an interest in the life

insurance contract in a reportable policy sale if the old interest previously was transferred for valuable consideration in a reportable policy sale (or is treated, under proposed §1.101-1(c)(3), as an interest in a life insurance contract that previously was transferred for valuable consideration in a reportable policy sale). Accordingly, the designation of death benefits as reportable death benefits is an attribute that transfers from the old interest to the new interest in a section 1035 exchange. See also proposed §1.6050Y-1(a)(12). The Treasury Department and the IRS previously have treated other attributes of contracts exchanged in section 1035 exchanges as transferring to the new contracts acquired. In this case, the proposed rule ensures that death benefits under the new interest are treated the same as under the old interest for purposes of reporting under section 6050Y(c) and §1.6050Y-4. These rules are necessary to ensure that the acquirer of an interest in a life insurance contract in a reportable policy sale cannot avoid the designation of the death benefits as reportable death benefits and the associated reporting of the payment of the reportable death benefits by simply exchanging the interest for a new life insurance contract. The proposed regulations also make conforming changes to §1.101-1(c)(1) of the final regulations to reflect the addition of proposed §1.101-1(c)(3).

4. Conforming modifications to §§1.6050Y-1 through 1.6050Y-4

Finally, consistent with proposed §1.101-1(c)(3), the proposed regulations would modify several definitions in §1.6050Y-1 of the final regulations and modify the reporting rules under §§1.6050Y-3 and 1.6050Y-4 of the final regulations to ensure proper reporting of reportable death benefits paid under contracts issued in section 1035 exchanges. Notably, however, the section 1035 exchange rules of proposed §1.101-1(c)(3) do not apply for purposes of §1.6050Y-2 of the final regulations, and no reporting is required under §1.6050Y-2 of the final regulations at the time of a section 1035 exchange, even if the new interest is exchanged for an old interest that was previously

transferred for valuable consideration in a reportable policy sale.

Proposed §1.6050Y-1(a)(14) provides that the term “reportable policy sale” has the meaning given to it in §1.101-1(c)(1), except as otherwise provided in §1.6050Y-1. Proposed §1.6050Y-1(a)(12) provides that the term “reportable death benefits” means amounts paid by reason of the death of the insured under a life insurance contract that are attributable to an interest in the contract that was transferred in a reportable policy sale described in §1.101-1(c)(1) of the final regulations or proposed §1.101-1(c)(3). Accordingly, payors of such amounts are subject to the reporting requirements of section 6050Y(c) and §1.6050Y-4 of the final regulations. Proposed §1.6050Y-1(a)(1) and (2) modify the definitions of “acquirer” and “buyer,” respectively, to treat as a buyer for purposes of reporting under section 6050Y(c) and §1.6050Y-4 a person to whom an interest in a life insurance contract is issued in a section 1035 exchange treated as the transfer of an interest in the life insurance contract in a reportable policy sale under proposed §1.101-1(c)(3). See §1.6050Y-4(a)(5) of the final regulations (requiring a payor of reportable death benefits to report the payor's estimate of investment in the contract with respect to the buyer, limited to the payor's estimate of the buyer's investment in the contract with respect to the interest for which the reportable death benefits payment recipient was paid).

To ensure proper reporting of reportable death benefits paid under contracts issued in section 1035 exchanges, proposed §1.6050Y-3(a) requires reporting by each “6050Y(b) issuer” that is a “section 1035 issuer” with respect to each “seller” at the time of the exchange. Proposed §1.6050Y-1(a)(8)(iii)(C) provides that the term “6050Y(b) issuer” includes any person that is a section 1035 issuer or the designee of a section 1035 issuer. Proposed §1.6050Y-1(a)(8)(v) defines the term “section 1035 issuer” to include the issuer of the old interest (old issuer) and the issuer of the new interest (new issuer) in a section 1035 exchange that is treated as the transfer of an interest in the life

insurance contract in a reportable policy sale under proposed §1.101-1(c)(3). The old issuer is a section 1035 issuer described in proposed §1.6050Y-1(a)(8)(v)(A), and the new issuer is a section 1035 issuer described in proposed §1.6050Y-1(a)(8)(v)(B). However, an issuer is not considered a section 1035 issuer if it never received information indicating that the interest in a life insurance contract with respect to which it is an issuer was transferred in a reportable policy sale under §1.101-1(c)(1) or (3). See proposed §1.6050Y-1(a)(8)(v)(A) and (B). Proposed §1.6050Y-1(a)(18) provides that, for purposes of reporting by both the old issuer and the new issuer, the term “seller” includes any person that holds an interest in a life insurance contract that has been transferred in a reportable policy sale under §1.101-1(c)(1) or (3) and exchanges that interest for an interest in a new life insurance contract in an exchange pursuant to section 1035. The information to be provided by a section 1035 issuer includes the name, address, and taxpayer identification number of the seller, the investment in the contract with respect to the seller, and any other information that is required by the form or its instructions. It is anticipated that this reporting will be completed on Form 1099-SB, “Seller's Investment in Life Insurance Contract”, and the information to be provided will also include the policy number (old or new, as applicable) and identification of the transaction as a section 1035 exchange. Under proposed §1.6050Y-3(a)(3), section 1035 issuers are not required to report the amount the seller would have received if the seller had surrendered the life insurance contract.

The proposed regulations make conforming changes to §1.6050Y-3(c) of the final regulations to provide the time and place for filing returns required to be made by section 1035 issuers. See proposed §1.6050Y-3(c) (section 1035 issuers file returns at the same time and place as other 6050Y(b) issuers). Proposed §1.6050Y-3(d)(1) provides that each section 1035 issuer must furnish a statement to each seller who makes a section 1035 exchange, just as other 6050Y(b) issuers are required to furnish

a statement to sellers, and proposed §1.6050Y-3(d)(2) imposes the same deadline for doing so. Additionally, proposed §1.6050Y-3(d)(1) requires the old issuer to furnish a statement to the new issuer in a section 1035 exchange providing information about the interest being exchanged. This statement serves to provide notice to the new issuer that the old interest was transferred in a reportable policy sale and, therefore, that the new interest will be treated as an interest in a life insurance contract that has been transferred in a reportable policy sale and that death benefits paid under the new interest are reportable death benefits. Proposed §1.6050Y-3(d)(2) provides that this statement must be furnished within 30 days of the section 1035 exchange.

The proposed regulations also modify the exception to reporting set forth in §1.6050Y-4(e)(3) of the final regulations. Section 1.6050Y-4(e)(3) of the final regulations provides an exception from reporting under §1.6050Y-4 of the final regulations if the payor never received, and has no knowledge of any issuer having received, a reportable policy sale statement (RPSS) with respect to the interest in a life insurance contract with respect to which the reportable death benefits are paid. However, death benefits paid with respect to the new interest may be reportable death benefits even though an RPSS was never furnished with respect to the new interest. Accordingly, the existing exception would apply too broadly in the context of section 1035 exchanges. Proposed §1.6050Y-4(e)(3) therefore imposes an additional requirement if the reportable death benefits are paid with respect to an interest in a life insurance contract issued in a section 1035 exchange. In that case, the exception applies only if the payor also never received, and has no knowledge of any issuer having received, a statement described in §1.6050Y-3(d)(1) from a section 1035 issuer or other information indicating that the issuance of the contract is treated as a transfer of an interest in the contract in a reportable policy sale under §1.101-1(c)(3).

Ordinary Course Trade or Business Acquisitions

As noted in the preamble to the final regulations, C corporations are not frequently used as vehicles for investing in life insurance contracts covering insureds with respect to which the corporation does not have a substantial business, financial, or family relationship at the time the contract is issued because a corporate level income tax applies to corporate earnings in addition to income tax on distributions at the shareholder level. See 84 FR 58460, 58467. After consideration of the comments and letter received on the 2019 proposed regulations and the final regulations, respectively, regarding ordinary course trade or business acquisitions, the Treasury Department and the IRS are proposing an exception for certain direct acquisitions of interests in life insurance contracts from a C corporation.

Proposed §1.101-1(c)(2)(v) provides that the direct acquisition of an interest in a life insurance contract from a C corporation by a C corporation is not a reportable policy sale if (1) the acquisition results from a transaction that qualifies as a reorganization under section 368(a); (2) immediately before the acquisition, (i) the interest is held by a C corporation that conducts an active trade or business within the meaning of §1.367(a)-2(d)(2) and (3), (ii) the C corporation does not engage in a trade or business of investing in interests in life insurance contracts, and (iii) no more than 5 percent of the gross value of the assets of the C corporation consists of life insurance contracts; and (3) immediately after the acquisition, (i) the acquiring C corporation does not engage in a trade or business of investing in interests in life insurance contracts, and (ii) not more than 5 percent of the gross value of the assets of the C corporation consists of life insurance contracts. This exception would provide relief from the reportable policy sale rules for acquisitions of interests in life insurance contracts through certain ordinary course trade or business acquisitions while preserving different treatment for direct and indirect acquisitions of interests in life insurance contracts in other cases. The proposed

regulations modify Example 11 in §1.101-1(g)(11) of the final regulations to reflect the addition of the exception in proposed §1.101-1(c)(2)(v). See proposed §1.101-1(g)(11).

Applicability Dates

Proposed §§1.101-1(b)(2)(iv) and (c)(3) are proposed to apply to section 1035 exchanges occurring on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**, and proposed §1.101-1(c)(2)(v) is proposed to apply to any acquisition of an interest in a life insurance contract occurring on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. See proposed §1.101-6(c). However, it is proposed that a taxpayer may choose to apply §1.101-1(b)(2)(iv), (c)(2)(v), and (c)(3) of the regulations set forth in the Treasury decision adopting these regulations as final regulations to all section 1035 exchanges and acquisitions occurring after December 31, 2017, and before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. See section 7805(b)(7) of the Code. Alternatively, a taxpayer may rely on proposed §1.101-1(b)(2)(iv), (c)(2)(v), and (c)(3) for all section 1035 exchanges and acquisitions occurring after December 31, 2017, and before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

The reporting obligations under proposed §1.6050Y-3 are proposed to apply to any section 1035 exchange treated as a reportable policy sale under proposed §1.101-1(c)(3) if the exchange occurs on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. See proposed §1.6050Y-1(b)(2). The reporting obligations under proposed §1.6050Y-4 are proposed to apply to reportable death benefits paid with respect to an interest in a life insurance contract issued in a section 1035 exchange treated as a reportable policy sale under proposed §1.101-1(c)(3) if the exchange occurs on or after the date the Treasury

decision adopting these regulations as final regulations is published in the **Federal Register**. See proposed §1.6050Y-1(b)(2). Any person with a reporting obligation under proposed §1.6050Y-3 or proposed §1.6050Y-4 may, however, rely on the proposed regulations with respect to all section 1035 exchanges occurring after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, and before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

I. Regulatory Planning and Review

The proposed regulations are not subject to review under section 6(b) of Executive Order 12866, as amended pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

II. Paperwork Reduction Act

The additional collection of information relating to this notice of proposed rulemaking will be submitted to the Office of Management and Budget for review under OMB Control Number 1545-2281 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). In general, the additional collection of information is required under section 6050Y. When an interest in a life insurance contract that was previously transferred in or is treated as having been previously transferred in a reportable policy sale (original contract) is exchanged by a policyholder under section 1035 for a new life insurance contract (new contract), proposed §1.6050Y-3(a) would require the issuer of the original contract (original issuer) to notify the issuer of the new contract (new issuer), the policyholder, and the IRS of the status of the original contract as a contract transferred in or treated as having been transferred in a reportable policy sale and to provide the investment in the contract for the original contract. Proposed §1.6050Y-3(a)

would also require any new issuer receiving such notification with respect to a section 1035 exchange to provide the policyholder and the IRS with the policy number of the new contract and the investment in the contract. This information is necessary to carry out the purpose of section 6050Y(c), which requires a payor of reportable death benefits to report certain information about payments of reportable death benefits.

The likely respondents to the collection of information are life insurance companies.

The burden for the additional collection of information contained in proposed §1.6050Y-3 will be reflected in the burden on Form 1099-SB, “Seller’s Investment in Life Insurance Contract”, when the burden is revised to reflect the additional collection of information in proposed §1.6050Y-3. The OMB Control Number for this form is 1545-2281.

Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by **[INSERT DATE 60 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be

enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

III. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires agencies to “prepare and make available for public comment an initial regulatory flexibility analysis,” which will “describe the impact of the proposed rule on small entities.” 5 U.S.C. 603(a). Section 605(b) of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

Pursuant to the RFA, it is hereby certified that the proposed regulations will not have a significant economic impact on a substantial number of small entities, because any effect on small entities by the rules proposed in this document flows directly from section 13520 of the TCJA. In addition, it is anticipated that requirements in the proposed regulations, which implement the statutory requirements under section 13520 of the TCJA, will fall primarily on financial and insurance firms with annual receipts greater than \$41.5 million and, therefore, on no small entities. Therefore, the Commissioner of the IRS hereby certifies that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Treasury Department and the IRS request comments on the impacts of this proposed rule on

small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small entities.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This proposed rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Comments and Requests for a Public Hearing

Before these proposed amendments to the final regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments

submitted, will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Kathryn M. Sneade, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

Availability of IRS Documents

The revenue rulings, notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.101-1 is amended by:

1. Adding a heading for paragraph (a) introductory text.
2. In paragraph (a)(1), adding a sentence after the fourth sentence.
3. In paragraphs (b) introductory text and (b)(2), revising the headings.

4. Adding paragraph (b)(2)(iv).
5. Adding a sentence at the end of paragraph (c)(1).
6. Revising paragraph (c)(2)(v).
7. Adding paragraph (c)(3).
8. In paragraph (e)(2), removing “, other than the issuance of a policy in an exchange pursuant to section 1035” in the last sentence.
9. In paragraph (g)(11), adding two sentences after the fourth sentence.
10. Adding paragraphs (g)(17) through (g)(19).

The additions and revisions read as follows:

§1.101-1 Exclusion from gross income of proceeds of life insurance contracts payable by reason of death.

(a) *Exclusion from gross income—*(1) *In general.* * * * The extent to which this exclusion applies in cases where life insurance policies have been gratuitously transferred or issued in an exchange pursuant to section 1035 (section 1035 exchange) is stated in paragraph (b)(2) of this section. * * *

* * * * *

(b) *Transfers and exchanges of life insurance policies.*

* * * * *

(2) *Other transfers and exchanges—** * *

* * * * *

(iv) *Section 1035 exchanges.* When an interest in a life insurance contract (old interest) is exchanged in a section 1035 exchange for an interest in a newly issued life insurance contract (new interest), except as otherwise provided by this section with respect to any portion of the new interest that is transferred or exchanged subsequent to the section 1035 exchange, the amount of the proceeds attributable to the new interest that is excludable from gross income under section 101(a) is determined as

follows:

(A) If, at the time of the exchange, the entire amount of the proceeds attributable to the old interest would have been excludable from gross income under section 101(a), the entire amount of the proceeds attributable to the new interest is excludable from gross income; and

(B) If, at the time of the exchange, less than the entire amount of the proceeds attributable to the old interest would have been excludable from gross income under section 101(a), the amount of the proceeds attributable to the new interest that is excludable from gross income is limited to the sum of the amount of the proceeds attributable to the old interest that would have been excludable at the time of the exchange and the premiums and other amounts subsequently paid with respect to the new interest by the policyholder, reduced (but not below zero) by amounts received by the policyholder under the life insurance contract that are not received as an annuity, to the extent excludable from gross income under section 72(e).

* * * * *

(c) * * *

(1) * * * See paragraph (c)(3) of this section for special rules applicable to section 1035 exchanges.

(2) * * *

(v) The direct acquisition of an interest in a life insurance contract by a C corporation if:

(A) Immediately before the acquisition, the interest is held by another C corporation (target C corporation) that actively conducts a trade or business within the meaning of §1.367(a)-2(d)(2) and (3);

(B) Immediately before the acquisition, the target C corporation does not engage in a trade or business of investing in interests in life insurance contracts;

(C) Immediately before the acquisition, no more than 5 percent of the gross value of the assets (as determined under paragraph (f)(4) of this section) of the target C corporation consists of life insurance contracts;

(D) The acquisition results from a transaction that qualifies as a reorganization under section 368(a) with respect to which the target C corporation and the acquiring C corporation each is a party to the reorganization (within the meaning of section 368(b));

(E) Immediately after the acquisition, the acquiring C corporation does not engage in a trade or business of investing in interests in life insurance contracts, and

(F) Immediately after the acquisition, no more than 5 percent of the gross value of the assets (as determined under paragraph (f)(4) of this section) of the acquiring C corporation consists of life insurance contracts.

(3) *Section 1035 exchanges.* This paragraph (c)(3) applies if an interest in a life insurance contract (old interest) is exchanged in a section 1035 exchange for an interest in a newly issued life insurance contract (new interest), and the old interest previously was transferred for valuable consideration in a reportable policy sale under paragraph (c)(1) of this section or is treated as an interest in a life insurance contract that previously was transferred for valuable consideration in a reportable policy sale under this paragraph (c)(3). For purposes of this section, the new interest is treated as an interest in a life insurance contract that previously was transferred for valuable consideration in a reportable policy sale. For purposes of §§1.6050Y-3 and 1.6050Y-4, the section 1035 exchange is treated as the transfer of an interest in the life insurance contract in a reportable policy sale.

* * * * *

(g) * * *

(11) * * * Also, the exception in paragraph (c)(2)(v) of this section applies,

provided Corporation X satisfies the requirements of paragraph (c)(2)(v)(A) through (C) of this section immediately before the acquisition by Corporation Y, and Corporation Y satisfies the requirements of paragraph (c)(2)(v)(E) and (F) of this section immediately after the acquisition. This would be the case even if A were no longer employed by Corporation X at the time of the transfer. * * *

* * * * *

(17) *Example 17.* The facts are the same as in *Example 4* in paragraph (g)(4) of this section except that, before A's death, C exchanges the policy on A's life for a new policy on A's life in a section 1035 exchange. The amount of the proceeds C may exclude from C's gross income under this section is limited under paragraph (b)(2)(iv)(B) of this section to \$6,000 plus any premiums and other amounts paid by C with respect to the original policy subsequent to the transfer and any premiums and other amounts paid by C with respect to the new policy subsequent to the exchange.

(18) *Example 18.* The facts are the same as in *Example 17* in paragraph (g)(17) of this section except that, before A's death, C sells the new policy to A for fair market value. A's estate receives the proceeds of \$100,000 on A's death. Under paragraph (b)(1)(ii)(B)(3)(i) of this section, the amount of the proceeds A's estate may exclude from gross income is not limited by paragraph (b) of this section.

(19) *Example 19.* A is the initial policyholder of a \$100,000 insurance policy on A's life. A transfers the policy for \$6,000, its fair market value, to an individual, C, who does not have a substantial family, business, or financial relationship with A at the time of the transfer. The transfer from A to C is a reportable policy sale. C also is the initial policyholder of a \$200,000 insurance policy on A's life. Before A's death, C exchanges the two policies on A's life for a single new policy on A's life in a section 1035 exchange. C receives the proceeds from the new policy on A's death. The entire amount of the proceeds attributable to the interest in the new policy that was issued in exchange for

the policy originally issued to C is excludable from gross income under paragraph (b)(2)(iv)(A) of this section. The amount of the proceeds attributable to the interest in the new policy that was issued in exchange for the policy originally issued to A that is excludable from gross income is limited under paragraph (b)(2)(iv)(B) of this section to \$6,000 plus any premiums and other amounts paid by C with respect to the policy originally issued to A subsequent to the transfer and any premiums and other amounts paid by C with respect to the interest in the new policy that was issued in exchange for the policy originally issued to A.

Par. 3. Section 1.101-6 is amended by adding paragraph (c) to read as follows:

§1.101-6 Effective date.

* * * * *

(c) Notwithstanding paragraphs (a) and (b) of this section, §1.101-1(b)(2)(iv) and (c)(3) apply to any interest in a life insurance contract issued in a section 1035 exchange occurring on or after the date these regulations are published as final regulations in the **Federal Register**, and §1.101-1(c)(2)(v) applies to any acquisition of an interest in a life insurance contract occurring on or after the date these regulations are published as final regulations in the **Federal Register**. However, under section 7805(b)(7), a taxpayer may choose to apply the rules in §1.101-1(b)(2)(iv), (c)(2)(v), and (c)(3) to all exchanges and acquisitions occurring after December 31, 2017, and before the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.6050Y-1 is amended by:

1. In paragraph (a)(1), adding a sentence at the end of the paragraph.
2. In paragraph (a)(2), adding “under §1.101-1(c)(1) or treated as such an interest under §1.101-1(c)(3)” before the second comma.
3. In paragraph (a)(8)(ii), removing the last sentence.
4. In paragraph (a)(8)(iii)(A), removing “or” at the end.

5. In paragraph (a)(8)(iii)(B)(2), removing the period at the end of the paragraph and adding in its place “; or”.
6. Adding paragraph (a)(8)(iii)(C).
7. Adding paragraph (a)(8)(v).
8. In paragraph (a)(12), adding “under §1.101-1(c)(1) or (3)” before the period at the end of the paragraph.
9. In paragraph (a)(14), removing “§1.101-1(c)” before the period at the end of the paragraph, and adding in its place “§1.101-1(c), except as otherwise provided in this section”.
10. In paragraph (a)(18)(i), removing “or” at the end of the paragraph.
11. In paragraph (a)(18)(ii), removing the period at the end of the paragraph and adding in its place “; or”.
12. Adding paragraph (a)(18)(iii).
13. Redesignating paragraphs (b)(1) through (5) as paragraphs (b)(1)(i) through (v); redesignating paragraph (b) introductory text as paragraph (b)(1); adding a heading to paragraph (b) introductory text; revising the heading for the newly redesignated paragraph (b)(1); revising the first two sentences of newly redesignated paragraph (b)(1); and adding paragraph (b)(2).

The additions and revisions read as follows:

§1.6050Y-1 Information reporting for reportable policy sales, transfers of life insurance contracts to foreign persons, and reportable death benefits.

(a) * * *

(1) * * * For purposes of determining the buyer under paragraph (a)(2) of this section, the term *acquirer* also includes any person to whom an interest in a life insurance contract is issued in an exchange pursuant to section 1035 (section 1035 exchange) that is treated as the transfer of an interest in the life insurance contract in a reportable policy sale under §1.101-1(c)(3).

* * * * *

(8) * * *

(iii) * * *

(C) Any person that is a section 1035 issuer or the designee of a section 1035 issuer.

* * * * *

(v) *Section 1035 issuer.* A section 1035 issuer is any person that, on the date of a section 1035 exchange of an interest in an existing life insurance contract for an interest in a newly issued life insurance contract that is treated as the transfer of an interest in a life insurance contract in a reportable policy sale under §1.101-1(c)(3), is:

(A) An issuer with respect to the existing life insurance contract, provided the issuer received an RPSS, a statement required by §1.6050Y-3(d)(1), or other information indicating that the existing life insurance contract or interest therein was transferred in a reportable policy sale under §1.101-1(c)(1) or (3); or

(B) An issuer with respect to the newly issued life insurance contract, provided the issuer receives the statement required by §1.6050Y-3(d)(1) or other information indicating that existing life insurance contract or interest therein was transferred in a reportable policy sale under §1.101-1(c)(1) or (3).

* * * * *

(18) * * *

(iii) For purposes of reporting under §1.6050Y-3 by both the section 1035 issuer described in paragraph (a)(8)(v)(A) of this section and the section 1035 issuer described in paragraph (a)(8)(v)(B) of this section, holds an interest in a life insurance contract that has been transferred in a reportable policy sale under §1.101-1(c)(1) or (3) and exchanges that interest for an interest in a new life insurance contract in a section 1035 exchange.

(b) *Applicability date*—(1) *In general*. Except as otherwise provided in paragraph (b)(2) of this section, this section and §§1.6050Y-2 through 1.6050Y-3 apply to reportable policy sales made after December 31, 2018. Except as otherwise provided in paragraph (b)(2) of this section, this section and §1.6050Y-4 apply to reportable death benefits paid after December 31, 2018. * * *

* * * * *

(2) *Section 1035 exchanges*. Section 1.6050Y-3 applies to a section 1035 exchange treated as a reportable policy sale under §1.101-1(c)(3) if the exchange occurs on or after the date these regulations are published as final regulations in the **Federal Register**. Section 1.6050Y-4 applies to reportable death benefits paid with respect to an interest in a life insurance contract issued in a section 1035 exchange treated as a reportable policy sale under §1.101-1(c)(3) if the exchange occurs on or after the date these regulations are published as final regulations in the **Federal Register**.

§1.6050Y-2 [Amended]

Par. 5. Section 1.6050Y-2 is amended by removing paragraph (f)(3).

Par. 6. Section 1.6050Y-3 is amended by:

1. In paragraph (a) introductory text, removing “that receives an RPPS or any notice of a transfer to a foreign person” in the first sentence and adding in its place “that receives an RPSS, receives any notice of a transfer to a foreign person, or is a section 1035 issuer”.
2. In paragraph (a)(3), removing “The” at the beginning of the paragraph and adding in its place “For 6050Y(b) issuers other than section 1035 issuers, the”.
3. In paragraph (c), removing “reportable policy sale or the transfer to a foreign person occurred” before the period at the end of the first sentence and adding

in its place “reportable policy sale, transfer to a foreign person, or section 1035 exchange occurred”.

4. In paragraph (d)(1), removing “is a reportable policy sale payment recipient or makes a transfer to a foreign person” in the first sentence and adding in its place “is a reportable policy sale payment recipient, makes a transfer to a foreign person, or makes a section 1035 exchange”, and adding a sentence at the end of the paragraph.
5. In paragraph (d)(2), removing “reportable policy sale or transfer to a foreign person occurred” before the period at the end of the first sentence and adding in its place “reportable policy sale, transfer to a foreign person, or section 1035 exchange occurred”, and adding a sentence after the second sentence.
6. In paragraph (f), removing “paragraph (f)(1), (2), or (3) of this section applies” before the period at the end of the paragraph and adding in its place “paragraph (f)(1) or (2) of this section applies”.
7. Removing paragraph (f)(3).

The additions read as follows:

§1.6050Y-3 Information reporting by 6050Y(b) issuers for reportable policy sales and transfers of life insurance contracts to foreign persons.

* * * * *

(d) * * *

(1) * * * In addition, every section 1035 issuer described in §1.6050Y-1(a)(8)(v)(A) filing a return required by paragraph (a) of this section with respect to a section 1035 exchange must furnish to each section 1035 issuer described in §1.6050Y-1(a)(8)(v)(B) with respect to that exchange a written statement showing the information required by paragraph (a) of this section with respect to the seller in the exchange and the name, address, and phone number of the information contact of the person filing the return.

(2) *Time for furnishing statement.* * * * Each statement required by paragraph (d)(1) of this section to be furnished to any section 1035 issuer described in §1.6050Y-1(a)(8)(v)(B) must be furnished within 30 days of the date of the section 1035 exchange.

* * *

* * * * *

Par. 7. Section 1.6050Y-4 is amended by adding a sentence at the end of paragraph (e)(3) to read as follows:

§1.6050Y-4 Information reporting by payors for reportable death benefits.

* * * * *

(e) * * *

(3) * * * Additionally, if the reportable death benefits are paid with respect to an interest in a life insurance contract issued in a section 1035 exchange, the payor never received, and has no knowledge of any issuer having received, a statement described in §1.6050Y-3(d)(1) from a section 1035 issuer or other information indicating that the issuance of the contract is treated as a transfer of an interest in the contract in a reportable policy sale under §1.101-1(c)(3).

* * * * *

Douglas W. O'Donnell,

Deputy Commissioner for Services and Enforcement.

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