

Reg. Section 1.101-1(b)(4)

Exclusion from gross income of proceeds of life insurance contracts payable by reason of death

(a)

(1) In general. Section 101(a)(1) states the general rule that the proceeds of life insurance policies, if paid by reason of the death of the insured, are excluded from the gross income of the recipient. Death benefit payments having the characteristics of life insurance proceeds payable by reason of death under contracts, such as workmen's compensation insurance contracts, endowment contracts, or accident and health insurance contracts, are covered by this provision. For provisions relating to death benefits paid by or on behalf of employers, see section 101(b) and §1.101-2. The exclusion from gross income allowed by section 101(a) applies whether payment is made to the estate of the insured or to any beneficiary (individual, corporation, or partnership) and whether it is made directly or in trust. The extent to which this exclusion applies in cases where life insurance policies have been transferred for a valuable consideration is stated in section 101(a)(2) and in paragraph (b) of this section. In cases where the proceeds of a life insurance policy, payable by reason of the death of the insured, are paid other than in a single sum at the time of such death, the amounts to be excluded from gross income may be affected by the provisions of section 101(c) (relating to amounts held under agreements to pay interest) or section 101(d) (relating to amounts payable at a date later than death). See §§1.101-3 and 1.101-4. However, neither section 101(c) nor section 101(d) applies to a single sum payment which does not exceed the amount payable at the time of death even though such amount is actually paid at a date later than death.

(2) Cross references. For rules governing the taxability of insurance proceeds constituting benefits payable on the death of an employee-

(i) Under pension, profit-sharing, or stock bonus plans described in section 401(a) and exempt from tax under section 501(a), or under annuity plans described in section 403(a), see section 72(m)(3) and paragraph (c) of §1.72-16;

(ii) Under annuity contracts to which §1.403(b)-3 applies, see §1.403(b)-7. For the definition of a life insurance company, see section 801; or

(iii) Under eligible State deferred compensation plans described in section 457(b), see paragraph (c) of §1.457-1.

(b) Transfers of life insurance policies.

(1) In the case of a transfer, by assignment or otherwise, of a life insurance policy or any interest therein for a valuable consideration, the amount of the proceeds attributable to such policy or interest which is excludable from the transferee's gross income is generally limited to the sum of (i) the actual value of the consideration for such transfer, and (ii) the

premiums and other amounts subsequently paid by the transferee (see section 101(a)(2) and example (1) of subparagraph (5) of this paragraph). However, this limitation on the amount excludable from the transferee's gross income does not apply (except in certain special cases involving a series of transfers), where the basis of the policy or interest transferred, for the purpose of determining gain or loss with respect to the transferee, is determinable, in whole or in part, by reference to the basis of such policy or interest in the hands of the transferor (see section 101(a)(2)(A) and examples (2) and (4) of subparagraph (5) of this paragraph). Neither does the limitation apply where the policy or interest therein is transferred 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 (see section 101(a)(2)(B)). For rules relating to gratuitous transfers, see subparagraph (2) of this paragraph. For special rules with respect to certain cases where a series of transfers is involved, see subparagraph (3) of this paragraph.

(2) In the case of a gratuitous transfer, by assignment or otherwise, of a life insurance policy or any interest therein, as a general rule the amount of the proceeds attributable to such policy or interest which is excludable from the transferee's gross income under section 101(a) is limited to the sum of (i) the amount which would have been excludable by the transferor (in accordance with this section) if no such transfer had taken place, and (ii) any premiums and other amounts subsequently paid by the transferee. See example (6) of subparagraph (5) of this paragraph. However, where the gratuitous transfer in question is made by or to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer, the entire amount of the proceeds attributable to the policy or interest transferred shall be excludable from the transferee's gross income (see section 101(a)(2)(B) and example (7) of subparagraph (5) of this paragraph).

(3) In the case of a series of transfers, if the last transfer of a life insurance policy or an interest therein is for a valuable consideration-

(i) The general rule is that the final transferee shall exclude from gross income, with respect to the proceeds of such policy or interest therein, only the sum of-

(a) The actual value of the consideration paid by him, and

(b) The premiums and other amounts subsequently paid by him;

(ii) If the final 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 final transferee shall exclude the entire amount of the proceeds from gross income;

(iii) Except where subdivision (ii) of this subparagraph applies, if the basis of the policy or interest transferred, for the purpose of determining gain or loss with respect to the final transferee, is determinable, in whole or in part, by reference to the basis of such policy or interest therein in the hands of the transferor, the amount of the proceeds which is excludable by the final transferee is limited to the sum of-

(a) The amount which would have been excludable by his transferor if no such transfer had taken place, and

(b) Any premiums and other amounts subsequently paid by the final transferee himself.



(4) For the purposes of section 101(a)(2) and subparagraphs (1) and (3) of this paragraph, a "transfer for a valuable consideration" is any absolute transfer for value of a right to receive all or a part of the proceeds of a life insurance policy. Thus, the creation, for value, of an enforceable contractual right to receive all or a part of the proceeds of a policy may constitute a transfer for a valuable consideration of the policy or an interest therein. On the other hand, the pledging or assignment of a policy as collateral security is not a transfer for a valuable consideration of such policy or an interest therein, and section 101 is inapplicable to any amounts received by the pledgee or assignee.

(5) The application of this paragraph may be illustrated by the following examples:

Example (1). A pays premiums of \$500 for an insurance policy in the face amount of \$1,000 upon the life of B, and subsequently transfers the policy to C for \$600. C receives the proceeds of \$1,000 upon the death of B. The amount which C can exclude from his gross income is limited to \$600 plus any premiums paid by C subsequent to the transfer.

Example (2). The X Corporation purchases for a single premium of \$500 an insurance policy in the face amount of \$1,000 upon the life of A, one of its employees, naming the X Corporation as beneficiary. The X Corporation transfers the policy to the Y Corporation in a tax-free reorganization (the policy having a basis for determining gain or loss in the hands of the Y Corporation determined by reference to its basis in the hands of the X Corporation). The Y Corporation receives the proceeds of \$1,000 upon the death of A. The entire \$1,000 is to be excluded from the gross income of the Y Corporation.

Example (3). The facts are the same as in example (2) except that, prior to the death of A, the Y Corporation transfers the policy to the Z Corporation for \$600. The Z Corporation receives the proceeds of \$1,000 upon the death of A. The amount which the Z Corporation can exclude from its gross income is limited to \$600 plus any premiums paid by the Z Corporation subsequent to the transfer of the policy to it.

Example (4). The facts are the same as in example (3) except that, prior to the death of A, the Z Corporation transfers the policy to the M Corporation in a tax-free reorganization (the policy having a basis for determining gain or loss in the hands of the M Corporation determined by reference to its basis in the hands of the Z Corporation). The M Corporation receives the proceeds of \$1,000 upon the death of A. The amount which the M Corporation can exclude from its gross income is limited to \$600 plus any premiums paid by the Z Corporation and the M Corporation subsequent to the transfer of the policy to the Z Corporation.

Example (5). The facts are the same as in example (3) except that, prior to the death of A, the Z Corporation transfers the policy to the N Corporation, in which A is a shareholder. The N Corporation receives the proceeds of \$1,000 upon the death of A. The entire \$1,000 is to be excluded from the gross income of the N Corporation.

Example (6). A pays premiums of \$500 for an insurance policy in the face amount of \$1,000 upon his own life, and subsequently transfers the policy to his wife B for \$600. B later transfers the policy without consideration to C, who is the son of A and B. C receives the proceeds of \$1,000 upon the death of A. The amount which C can exclude

from his gross income is limited to \$600 plus any premiums paid by B and C subsequent to the transfer of the policy to B.

Example (7). The facts are the same as in example (6) except that, prior to the death of A, C transfers the policy without consideration to A, the insured. A's estate receives the proceeds of \$1,000 upon the death of A. The entire \$1,000 is to be excluded from the gross income of A's estate.