

# HOW ARE LIFE SETTLEMENTS TAXED?



## KEY TAKEAWAYS: LIFE SETTLEMENT TAXATION

- After a favorable revision during the Tax Cuts and Jobs Act of 2017, taxation on life settlements is often non-existent or minor in the overall transaction.
- There are three tiers affecting how a life settlement is taxed. See the chart to the right for a detailed description of the three tiers.
- In most cases, if any taxes are owed on the sale, the taxation will be only long-term capital gains. Consider the taxation example below.

## TAX BREAKDOWN

PORTION OF PRE-TAX NET OFFER	TAXATION
<b>COST BASIS:</b> The portion of your contract that is typically your total premium payments	Tax-Free
<b>CASH SURRENDER VALUE OVER COST BASIS:</b> The portion of your cash surrender value that is greater than your cost basis (most cases is \$0)	Ordinary Income
<b>GAIN OVER CASH SURRENDER VALUE:</b> The portion of your policy pre-tax net offer that is greater than your cash surrender value less cost basis	Long-Term Capital Gains

## TAXATION EXAMPLE

POLICY AMOUNT	\$1,000,000
LIFE SETTLEMENT OFFER	\$450,000
COST BASIS	\$350,000
CASH SURRENDER VALUE	\$75,000

## HOW THE SALE WOULD BE TREATED

PRE-TAX OFFER	\$450,000
ESTIMATED TAX	<u>(\$15,000)</u>
AFTER-TAX NET OFFER	\$435,000

In certain instances, when the life expectancy is two years or less, the transaction could be considered a tax-free viatical settlement with no tax owed.

## TAX CALCULATION

Pre-Tax Net Offer	\$450,000
Cost Basis (this portion is tax free)	\$350,000
<b>Total Gain</b>	<b>\$100,000</b>
Cash Surrender Value	\$75,000
Cost Basis	\$350,000
<b>Cash Surrender Value – Cost Basis</b>	<b>\$0</b>
<b>Total Ordinary Income Tax (32%)*</b>	<b>\$0</b>
Total Gain	\$100,000
Cash Surrender Value – Cost Basis	\$0
<b>Total Capital Gain</b>	<b>\$100,000</b>
<b>Total Capital Gains Tax (15%)*</b>	<b>\$15,000</b>

\*Individual tax rates may vary. Valmark recommends working with a tax professional when determining actual taxes on a specific transaction.