Tax Insights
from Insurance

Final regulations confirm treatment of life insurance policy exchanges

July 20, 2026

In brief

What happened?

Treasury and the IRS published on July 9 final regulations (the 2026 final regulations) regarding reportable policy sales of life insurance contracts and payments of reportable death benefits under the 2017 Tax Cuts and Jobs Act (the Act). The 2026 final regulations adopt, with certain modifications, the proposed regulations published on May 10, 2023 (the 2023 proposed regulations), addressing the treatment of life insurance contracts received in a tax-free exchange under Section 1035, and the treatment of such contracts received in the ordinary course of business acquisitions.

Why is it relevant?

The 2026 final regulations apply to any life insurance contract acquired in a tax-free exchange under Section 1035 or an acquisition that occurs on or after July 9, 2026. However, taxpayers may choose to apply the 2026 final regulations to all exchanges and acquisitions occurring after December 31, 2017.

Actions to consider

Taxpayers who own life insurance policies (including corporate-owned life insurance (COLI) or similar policies) and engage in tax-free policy exchanges should consider whether the 2026 final regulations excuse them from existing rules related to reportable policy sales. Issuers of life insurance contracts that are involved in Section 1035 exchanges of contracts previously transferred in a reportable policy sale should review the streamlined information reporting procedures adopted in the 2026 final regulations, which differ from what was proposed in 2023.

Corporate acquirers of interests in life insurance contracts in tax-free reorganizations should analyze the treatment of those contracts under the 2026 final regulations.

In detail

Background

Section 101 generally excludes from gross income amounts received under a life insurance contract by reason of the death of the insured. To qualify as a life insurance contract for purposes of Section 101, however, the contract must satisfy the requirements in Section 7702. Although death benefits paid under a qualifying life insurance contract generally are excludable from gross income under Section 101(a)(1), the sale or other disposition of a life insurance contract by its owner may result in the recognition of taxable gain and the buyer's exclusion may be limited under the "transfer-for-value" rule of Section 101(a)(2). Exceptions to the transfer-for-value rule apply to certain tax-free transactions, as well as transfers 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.

2017 Act changes

The Act added Section 6050Y to the Internal Revenue Code, imposing information reporting obligations on the acquirer of a life insurance contract, the issuer of the contract, and the payor of death benefits under the contract, when there is a "reportable policy sale."

The Act also added Section 101(a)(3), defining the term "reportable policy sale" as a direct or indirect acquisition of a life insurance contract if the acquirer has no substantial "family, business, or financial relationship" with the insured. For this purpose, an indirect transfer includes the acquisition of an interest in a partnership, trust, or other entity that owns a life insurance contract. If there is a reportable policy sale, then the exceptions to the transfer-for-value rule will not apply. In other words, a portion of the death benefits will be taxable when received.

2019 final regulations

Final regulations published in 2019 (the 2019 final regulations) address the application of the reportable policy sale rules. In particular, the regulations explain a "reportable policy sale," a "substantial relationship," and an "interest in a life insurance contract." The final regulations also are the basis for (1) an acquirer to file Form 1099-LS for a reportable policy sale under Section 6050Y(a); (2) the issuer of a contract that was the subject of a reportable policy sale to file Form 1099-SB, reporting the seller's investment in the contract and surrender amount under Section 6050Y(b); and (3) the payor of reportable death benefits to report amounts under Section 6050Y(c).

Before 2019, the transfer-for-value rule of Section 101(a)(2) did not apply as the result of a tax-free policy exchange by the original owner of the policy. Under Reg. sec. 1.101-1(e)(2), the issuance of a new policy in a tax-free exchange is a transfer of an interest in a life insurance contract. Therefore, the policy is subject to the transfer-for-value rule unless an exception to the rule applies. For such an exception to apply, there must be a substantial business, family, or financial relationship between the policy owner and the individual whose life is insured under the policy.

The 2019 final regulations also differentiated between a tax-free transaction involving stock in a corporation that owned life insurance policies and a tax-free asset acquisition wherein some of the assets are life insurance policies. Under the 2019 final regulations, the former could be excluded from the definition of reportable policy sale if certain requirements were met, whereas the latter could not.

2026 final regulations compared to the 2023 proposed regulations

Section 1035 exchanges

The preamble to the 2026 final regulations confirms that Reg. sec. 1.101-1(e)(2) inadvertently changed the treatment of tax-free policy exchanges, and that the change was inappropriate. At the same time, Treasury and the IRS remain concerned that the owner of a policy that was the subject of a previous reportable policy sale should not be able to avoid the consequences of the previous sale by entering into a tax-free exchange for a newly issued policy.

The 2026 final regulations, accordingly, adopt the following changes to existing guidance under Section 101, largely as outlined in the 2023 proposed regulations, but with clarifying modifications addressing the treatment of “boot” received in a Section 1035 exchange:

- Modify the definition of a transfer of an interest in a life insurance contract to exclude the issuance of a new policy in a tax-free exchange, without qualification;
- Provide a new rule to determine the amount excluded from gross income when a death benefit is received under a contract that was issued in exchange for a pre-existing contract that was subject to a prior reportable policy sale, clarified to address boot received in the tax-free exchange; and
- Modify the definition of reportable policy sale to ensure that a policy received in exchange for a policy that was the subject of a previous reportable sale is itself treated as the subject of a previous reportable policy sale.

Unlike the 2023 proposed regulations, which would have required both the issuer of the old contract (old issuer) and the issuer of the new contract (new issuer) in a Section 1035 exchange to file information returns with the IRS and furnish statements to policyholders, the 2026 final regulations do not adopt these requirements. Instead, the 2026 final regulations add Reg. sec. 1.6050Y-3(h), which requires only the old issuer to provide the new issuer with information necessary for proper reporting of reportable death benefits, including the policyholder’s investment in the contract and a statement as to whether the old issuer would have reported reportable death benefits had they been paid on the date of the exchange. No filing with the IRS is required with respect to the Section 1035 exchange itself, and issuers have no obligation to furnish statements to policyholders making the exchange.

The 2026 final regulations do not require additional reporting on Form 1099-R at this time, but anticipate that a new distribution code for Box 7 of Form 1099-R will be added to identify a Section 1035 exchange of a contract previously transferred in a reportable policy sale. This reporting will not be required until the IRS publishes a revised final Form 1099-R and instructions.

***Observation*:** The 2026 final regulations confirm the treatment of tax-free exchanges in the 2023 proposed regulations. In addition, the 2026 final regulations simplify the reporting obligations compared to the information reporting procedures in the 2023 proposed regulations.

Acquisitions of interests in a life insurance contract

The 2026 final regulations also adopt, without change from the 2023 proposed regulations, a new *de minimis* exception to the rules for reportable policy sales in the case of ordinary course trade or business acquisitions of life insurance policies, notwithstanding comments requesting that the exception be broadened. Specifically, under the 2026 final regulations, 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:

- The acquisition results from a transaction that qualifies as a reorganization under Section 368(a);
- Immediately before the acquisition, the interest is held by a C corporation that conducts a trade or business, the C corporation does not engage in a trade or business of investing in life insurance contracts, and life insurance contracts represent no more than 5% of the C corporation's gross assets; and
- Immediately after the acquisition, the acquiring C corporation does not engage in a trade or business of investing in life insurance, and life insurance contracts represent no more than 5% of the acquiring C corporation's gross assets.

Observation: The change to ordinary course trade or business acquisitions of life insurance contracts provides greater consistency between trade or business acquisitions that are stock transactions and those that are asset transactions.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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