Transfer for Value Rule

As a general principle, the proceeds of a life insurance policy paid by reason of the insured's death are exempt from federal income tax. The transfer for value rule is an exception to this general principle.

Thus, after the initial issuance of a policy, if it is subsequently transferred for "valuable consideration," the income tax exclusion under §101(a) is lost, and the beneficiary will have to include in gross income, the proceeds received, to the extent that they exceed the consideration paid by the transferee of the policy and any subsequent premium payments or other costs of maintaining the policy subsequent to the transfer [I.R.C. §101(a)(2)].

Policy Owner and Tranferer	*Transferee for Value*	*Tax Impact on Death Benefit*
Anyone	Insured	Proceeds Exempt
Anyone	Partner of Insured	Proceeds Exempt
Anyone	Partnership in which insured is a partner	Proceeds Exempt
Anyone	Corporation in which insured is a shareholder or officer	Proceeds Exempt
Anyone	Anyone where basis is determined by reference to transferor's basis	Proceeds Exempt
Anyone	Co-Stockholder of Insured	Proceeds Taxable
Anyone	Anyone Else	Proceeds Taxable

For discussion purposes only. This chart illustrates generic situations and does not represent tax or legal advice.

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