AGENDA

1. Advisory Fees and Non-Qualified Annuities
2. Reportable Policy Sales
3. SECURE Act
4. Miscellaneous Topics
ADVISORY FEES AND NON-QUALIFIED ANNUITIES
ADVISORY FEES

Background

- Policyholder of a deferred annuity chooses a third party adviser
- Adviser provides advice and services relating to the contract
- Recurring fee is charged against the account value and paid to the adviser
- Old model, but becoming more common
ADVISORY FEES

PLRs – Qualified Retirement Arrangements

• Qualified plans, IRC section 403(b) contracts, and IRAs
• Account / annuity contract was “solely liable” for paying the fee
• The fee is characterized as an expense of the arrangement
• The assessment of the fee does not constitute a distribution
• PLR 9845003, PLR 9332040, PLR 9316042, PLR 9047073, PLR 9005010, PLR 8951910
ADVISORY FEES

PLRs – Non-Qualified Annuities

• Until this year, only one ruling released: PLR 9342053
  • Facts indistinguishable from “qualified” arrangements
  • IRS was adverse
  • Fee is an expense of the policyholder for services the adviser provides to the policyholder
  • The fact that the contract was solely liable for the fee does not “convert” the fee into an expense of contract
  • The policyholder is the only party directly benefiting from the adviser’s services
  • The assessment of the fee constitutes an amount received that is includible in gross income under IRC section 72(e) (income-first rule)
  • 10% penalty tax also may apply (if taxpayer younger than age 59½)
ADVISORY FEES

PLRs – Non-Qualified Annuities

• 18 PLRs involving advisory fees and non-qualified annuities have been released

• Conclusion: **Assessment of the fee is not a distribution**
  • Conforms the tax treatment of non-qualified annuities to the earlier PLRs on qualified arrangements, at least under the facts presented
  • Reflects a reversal of the position taken in PLR 9342053

• Like any PLR, the new rulings:
  • Cannot be cited as precedent
    • But they are treated as authority for the “reasonable basis” and “substantial authority” exceptions to IRC section 6662 accuracy-related penalties
  • Address only the specific facts presented
PLRs – Facts of New PLRs on Non-Qualified Annuities

- Non-qualified annuities
  - Not IRAs and not part of any qualified retirement arrangement
  - Issued to an individual or a trust for an individual’s benefit
  - Three types of contracts:
    - One is a “variable contract” under IRC section 817(d)
    - The other two are not variable contracts under IRC section 817(d)

- Allocation options
  - Cash value is credited with earnings or interest based on “Options” the owner selects from a menu the issuer provides
PLRs – Facts of New PLRs on Non-Qualified Annuities (cont.)

- “Contract is designed for Owners who will receive ongoing investment advice from an investment adviser … on how to allocate the Contract’s cash value … among the available Options.”
- Adviser is expected to take into account factors such as:
  - Owner’s personal risk tolerance and investment timeline
  - Interest rate and market environment
  - Menu of Options available under the Contract
  - Various other benefits and features available under the Contract
ADVISORY FEES

PLRs – Facts of New PLRs on Non-Qualified Annuities (cont.)

• Adviser is appropriately licensed and in the business of providing investment advice
• The adviser will not receive a commission for the sale of the contract from the contract issuer
ADVISORY FEES

PLRs – Facts of New PLRs on Non-Qualified Annuities (cont.)

- The contemplated fees:
  - The contract owner will authorize investment advisory fees to be paid periodically from the contract’s cash value to the adviser as consideration for the advice the adviser provides.
  - The fees will be determined based on an arms-length transaction between the contract owner and the adviser.
  - The fees will compensate the adviser only for investment advice that the adviser provides to the owner with respect to the contract, and not for any other service.
  - The fees will not result in any reduction in fees related to any other asset or for any other service.
ADVISORY FEES

PLRs – Facts of New PLRs on Non-Qualified Annuities (cont.)

• Fees will not exceed an amount equal to an annual rate of 1.5% of the contract’s cash value (within the meaning of IRC section 72(e)(3)(A)(i)),

• Determined at the time and in the manner provided in the written authorization for the fees

• In all events based on the cash value during the period to which the fees relate
ADVISORY FEES

PLRs – Facts of New PLRs on Non-Qualified Annuities (cont.)

• Contract is “solely liable” for the fees:
  • During any period for which the written fee authorization is in effect, the annuity contract will be solely liable for paying the fees
  • The fees will not be paid directly by the owner
  • The owner will not have the right to direct payment of the fees for any other purpose or to any other person
ADVISORY FEES

PLRs – Analysis in New PLRs on Non-Qualified Annuities

• The advisory fees are integral to the operation of the contract
  • During any period during which the fee authorization is in effect, the owner will receive ongoing investment advice with respect to the contract so that the owner may properly utilize the contract
  • The adviser is expected to help the owner select Options related to the contract

• Taxpayer represented that:
  • The fees will not serve as consideration for anything other than investment advice provided by the adviser in relation to the contract
  • The fees will not exceed the 1.5% limitation
  • Based on these representations, the fees will be used only to pay for investment advisory services relating to the contract
ADVISORY FEES

PLRs – Analysis in New PLRs on Non-Qualified Annuities (cont.)

- Because the Contracts are designed to work with an adviser, the contract is solely liable for the fees.
- The fees do not constitute compensation to the adviser for services related to any assets of the owner other than the contract or any services other than investment advice services with respect to the contract.
- Therefore, the fees are an expense of the contract, not a distribution to the owner.
- More technically, the fees the annuity issuer deducts from the contract’s cash value and remits to the adviser will not be treated as an “amount received” by the owner for purposes of IRC section 72(e).
ADVISORY FEES

PLRs – Specific IRS Caveats Included in the New PLRs

“The ruling contained in this letter does not apply to any amount paid by Taxpayer that compensate the Advisor for services related to assets other than the Contract or for any services provided other than investment advice services with respect to the Contract. Any such amount would be an ‘amount received’ by the Owner of the Contract for purposes of section 72(e).”

“No opinion is expressed as to the tax treatment of the transaction under the provisions of any of the other sections of the Code and regulations which may also be applicable thereto or to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction which are not specifically covered by the above rulings.”
REPORTABLE POLICY SALES
REPORTABLE POLICY SALES

Background

• Tax Cuts & Jobs Act (2017)
  • Added IRC section 6050Y – reporting for any “reportable policy sale” (RPS) or for any transfer of a life insurance contract to a foreign person
  • Amended IRC section 101(a)(2) – transfer for value rule in a RPS
  • Overturned IRS guidance on “adjusted basis” in policy sale
• Proposed regulations released March 2019
  • Notice 2018-41 sought comments before proposed regulations
• Final regulations released October 25, 2019
  • Published in Federal Register on October 31, 2019
Definition of Reportable Policy Sale

• “The acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer’s interest in such life insurance contract.”
Definition of Reportable Policy Sale (cont.)

• An indirect acquisition of an interest occurs when a person becomes a beneficial owner of a partnership, trust, or other entity that holds an interest in the life insurance contract.

• Includes the creation of an enforceable right to proceeds.

• Generally does not include:
  • The designation of a revocable beneficiary.
  • A collateral assignment of the contract.
  • The issuance of a contract, other than in a 1035 exchange, or
  • Certain ordinary course business transactions.
Definition of Reportable Policy Sale – 1035 Exchanges

- **Contract issuer** in a 1035 exchange:
  - Owner’s assignment of old contract to the new carrier as part of the exchange transaction is **not** a RPS

- **Contract owner** in a 1035 exchange:
  - Owner’s “acquisition” of the new contract in the exchange is a RPS, unless the policyholder has the requisite relationship with the insured
  - So, the mere issuance of a new contract in a 1035 exchange is both an “acquisition” of a contract and can be a RPS
Definition of Reportable Policy Sale – 1035 Exchanges
(cont.)

- If an exchange is a RPS:
  - The policyholder (acquirer) must furnish a RPSS to the issuer, and
  - The issuer generally must report any reportable death benefits, but
  - The other reporting requirements generally do not apply
- Preamble explains IRS concern:
  - If a contract was transferred in an earlier RPS and then exchanged, the death benefits would not get reported properly
Indirect Acquisitions Involving C Corporations

- **General rule:**
  - An indirect acquisition of a life insurance contract occurs if a person acquires an interest in a partnership, trust, or “other entity” that holds the contract.

- **Exception:**
  - The term “other entity” does not include a C corporation if no more than 50% of its gross assets consist of life insurance.
  - So, the acquisition of an interest in such a C corporation is not an acquisition of a life insurance contract and thus is not a RPS.
Indirect Acquisitions Involving C Corporations (cont.)

- Exception not available for direct acquisitions:
  - For the foregoing exception to apply, the C corporation must survive as an entity following the acquisition of an interest in the C corporation
  - If the corporate existence terminates, the transaction is a direct acquisition of the life insurance contracts
  - This would include certain corporate asset reorganizations
  - If the exception is unavailable, the acquirer must have the requisite relationship with the insured(s) or the transaction will be a RPS
  - If the transaction is a RPS, the transfer for value rule could apply because the “carryover basis” exception to that rule is not available for any RPS
REPORTABLE POLICY SALES

Other Exceptions to Definition of RPS

- Transfer between entities with the same beneficial owners
  - Subject to certain variance standards and other rules
- Transfer between corporations that are part of an affiliated group
- Indirect acquisition by a person if:
  - A partnership, trust, or other entity in which an ownership interest is being acquired holds the interest in the life insurance contract, and either
  - Acquired that interest before 2019, or
  - Acquired that interest in a RPS that was previously reported
REPORTABLE POLICY SALES

Other Exceptions to Definition of RPS (cont.)

• Indirect acquisition by a person if:
  • No more than 50% of the gross value of the assets of the partnership, trust, or other entity that holds the life insurance contract and in which the ownership interest is being directly acquired consists of life insurance contracts
  • But only if, immediately after the person acquires the ownership interest in the entity, that person (and family) own 5% or less of the entity
  • The regulations articulate slightly different standards for this ownership test in the case of S corporations, trusts, and partnerships or other entities that are not corporations or trusts
REPORTABLE POLICY SALES

Substantial Relationship Standards

- **Substantial family relationship**
  - Spouses, parents, grandparents, great-grandparents, lineal descendants

- **Substantial business relationship**
  - The insured is a key person of, or materially participates in, an active trade or business as an owner, employee, or contractor and at least 80% of that trade or business is owned by the acquirer
  - Acquisition of a trade or business if the insured:
    - Is an employee within the meaning of IRC section 101(j)(5)(A), or both of the following:
      - Was a director, highly compensated employee, or highly compensated individual within the meaning of IRC section 101(j)(2)(A)(ii), and
    - The acquirer has ongoing financial obligations to the insured with respect to his/her employment (such as to fund current or future benefit obligations based on the insured’s relationship with the entity)
Substantial Relationship Standards (cont.)

- **Substantial financial relationship**
  - Common investment with the insured (other than life insurance contracts) and a buy-out of the insured’s interest by the co-investors after death is reasonably foreseeable
  - Acquirer maintains the contract to provide funds to:
    - Purchase assets or to satisfy liabilities of the insured or the insured’s estate, heirs, etc., or
    - Satisfy other liabilities arising upon or by reason of the insured’s death
  - Acquirer is a charity and certain requirements are met
REPORTABLE POLICY SALES

Reporting Requirements – Three General Requirements

- Reporting the Sale:
  - Every acquirer of a life insurance contract in a RPS must file information returns with the IRS and provide statements to the issuer and the RPS payment recipient.

- Reporting Seller’s Basis:
  - Every issuer that receives the foregoing statement or gets notice of a transfer to a foreign person must file information returns with the IRS and provide statements to the seller.

- Reporting the Death Benefit:
  - Every issuer that pays a “reportable death benefit” must file information returns with the IRS and provide statements to the death benefit recipient.
REPORTABLE POLICY SALES

Reporting the Sale - IRC section 6050Y(a)

• Every acquirer involved in a RPS must:
  • File new IRS Form 1099-LS with the IRS
  • Furnish statement to the RPS payment recipient
  • Furnish statement to the contract “issuer” (but only if it’s a direct acquisition)
    • Called a “reportable policy sale statement” or RPSS
  • Form 1099-LS includes the following information:
    • Acquirer’s name, address, and TIN
    • Payment recipient’s name, address, and TIN
    • Contract issuer and policy number
    • Date of the RPS
    • Amount of the payment (cash and FMV of any other consideration)
REPORTABLE POLICY SALES

Reporting the Seller’s Basis – IRC section 6050Y(b)

• Issuer of contract involved in a RPS must:
  • File new IRS Form 1099-SB with the IRS
  • Furnish statement to persons named in the Form 1099-SB
• Issuer’s reporting obligation is conditioned on:
  • Receiving a RPSS from the acquirer (a copy of Form 1099-LS), or
  • Receiving notice of a transfer of the contract to a foreign person
    • Broadly defined but must include “foreign indicia”
• Form 1099-SB includes the following information:
  • Seller’s name, address, and TIN
  • Investment in the contract (or an estimate if seller is not the original owner)
  • Surrender amount (if seller would have surrendered the contract)
  • Policy number
REPORTABLE POLICY SALES

Reporting the Death Benefits – IRC section 6050Y(c)

• Issuer of contract involved in a RPS must:
  • Report any “reportable death benefit” on Form 1099-R or 1042-S
  • Furnish payee statement
  • Forms have been updated to accommodate this reporting

• Reportable death benefit defined:
  • Attributable to an interest in the contract that was transferred in a RPS

• Issuer’s obligations conditioned on:
  • Having received RPSS
  • Having knowledge of any issuer having received RPSS
REPORTABLE POLICY SALES

Who is the “Issuer?”

- In general, the issuer means:
  - any person that bears any part of the risk with respect to the contract,
  - persons responsible for administering the contract

- Indemnity reinsurer and the original issuer are both “issuers”

- Can include a designee of an issuer

- Acquirer needs to report (provide RPSS) only to the issuer responsible for administering the contract on the date of the RPS

- For transfers to foreign persons, an issuer is any person that:
  - receives notice of the transfer, and
  - was an issuer on the date of transfer or receipt of notice.
  - If an issuer that is not responsible for administering the contract receives the notice, it can avoid the reporting requirement by passing the notice to the issuer that is responsible for administering the contract
REPORTABLE POLICY SALES

Changes to the Transfer for Value Rule

- The death benefit under a life insurance contract generally is excluded from gross income under IRC section 101(a).
- However, if a life contract is transferred for value, the amount excluded is limited generally to the consideration and premiums paid, subject to certain exceptions for certain 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 or officer.
- These exceptions do not apply to reportable policy sales.
**REPORTABLE POLICY SALES**

**Effective Date and Transition Rules**

- **Reporting rules:**
  - Apply only to reportable policy sales made and reportable death benefits paid *after* 2018
  - Transition relief for transactions occurring in 2019 and on/before **October 31, 2019**

- **Transfer for value rule:**
  - For purposes of determining the amount of death benefits that are excludable under IRC section 101, the final regulations under that section apply to death benefits under contracts transferred *after* **October 31, 2019**
  - But can choose to apply the final regulations starting with death benefits paid under contracts transferred after 2017 and on or before October 31, 2019

- More relief than the proposed regulations
REPORTABLE POLICY SALES

Adjusted Basis

- TCJA also amended cost basis rules for policy sales
- Rev. Rul. 2009-13 held that basis is reduced by COI for certain policy sales
- TCJA amended IRC section 1016(a)(1) to reverse the IRS position
  - No adjustments are made to a taxpayer’s basis “for mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract”
  - Retroactive to August 25, 2009
SECURE ACT
SECURE ACT

Setting Every Community Up For Retirement Enhancement Act (SECURE Act)

- **Timeline of Passage:**
  - The SECURE Act passed the House on May 23rd, 417-3 and stalled in the Senate until mid-December
  - Eventually passed as part of the two-bill spending package and signed into law on December 20th
SECURE Act

- Annuity-related provisions:
  - Fiduciary safe harbor for selection of lifetime insurance providers
    - The provision enhances the current safe harbor protection for employers to assess life insurers to provide annuities under qualified plans
  - Disclosures regarding lifetime income
    - Annual disclosure required on defined contribution plans to specify how much income retirement savings could generate
    - Income figure generated on an assumption that the entire savings account would be used to purchase an annuity
  - Expands portability of lifetime income options
    - Participants would be allowed to take a distribution of a lifetime income investment without regard to the restrictions on plan withdrawals
SECURE ACT

Other Notable SECURE Act Provisions

• Post 70½ contributions to traditional IRAs
  • Allows those still working to contribute to traditional IRAs after age 70½

• Increased required beginning date age
  • Required beginning date moved to age 72 from 70½
  • Effective for taxable years after December 31, 2019 (applicable to those who have not already reached age 70½ by the end of 2019)

• Penalty-free distributions upon birth or adoption
  • Participants may withdraw up to $5,000 penalty-free from any defined contribution plan or IRA upon birth or adoption of a child
  • Effective for distributions after December 31, 2019
SECURE ACT

Post-Death RMDs

• 10-year rule applies generally
  • Regardless of whether death on/after RBD

• Exceptions for:
  • An “eligible designated beneficiary” (“EDB”)
  • Beneficiary that is not a “designated beneficiary”
  • Some grandfathered treatment and delayed effective dates
  • Defined benefit plans
SECURE ACT

Post-Death RMDs

- EDBs
  - “Designated beneficiary” who is:
    - Surviving spouse
    - Minor child of the employee
    - Disabled
    - Chronically ill
    - Not more than 10 years younger than employee
  - Can “stretch” over life/life expectancy
  - Status determined at employee’s death
  - Minor ceases to be an EDB at majority
  - Upon death of EDB, 10-year rule applies
- Spousal rollover/continuation still available
SECURE ACT

Post-Death RMDs

• Special rules for certain trusts
  • See-through trusts
  • Multi-beneficiary trusts
• Prior law applies to beneficiary that is not a “designated beneficiary”
  • Generally, a non-individual beneficiary (e.g., estate, charity, non-see-through trust)
• Under prior law:
  • If death occurs prior to RBD, the 5-year rule or lifetime payout rule applies
  • If death occurs on/after RBD, the at-least-as-rapidly rule applies
MISCELLANEOUS TOPICS
MISCELLANEOUS TOPICS

PLR 201930025

• Ruling under IRC section 7702B regarding a qualified long-term care insurance contract that has a “premium stabilization feature” (PS Feature) and a refund of premium death benefit (ROP Death Benefit)

• Under the PS Feature, a premium stabilization amount (PS Amount) may be used to –
  • Offset premiums
  • Be paid as an ROP Death Benefit not to exceed X% of aggregate premiums paid by the owner

• No benefit under the PS Feature is provided upon termination of the contract

• ROP Death Benefit satisfies timing and amount restrictions of IRC section 7702B(b)(2)(C)
Proposed Regulation under IRC section 3405(e)(13)

- IRC section 3405(e)(13) generally prohibits payees from electing out of withholding from designated distributions that are delivered outside of the U.S.
- Proposed regulation largely follows Notice 87-7 but makes certain clarifications

Scenarios addressed:
- Payees with military or diplomatic Post Office address
- Payees with residence address located within the U.S.
- Payees with a residence address located outside of the U.S. and payees who have not provided a residence address
- Payments subject to withholding under IRC section 1441
Rev. Rul. 2019-19

Facts

- A distribution is required to be made from the plan to the Individual in 2019
- Employer distributes the amount and withholds tax as required under IRC section 3405(d)(2)
- Employer mails a check and the Individual actually receives the check and could have cashed it in 2019
- Individual does not cash the check and does not make a rollover contribution

IRS held:

- Individual A must include the amount in gross income in 2019
- Employer must withhold tax and is liable for payment of that tax
- Employer must report the designated distribution on Form 1099-R for 2019
MISCELLANEOUS TOPICS

2019-2020 Priority Guidance Plan (selected items)

- Finalize reportable policy sale regulations
- Guidance on missing participants
- Regulations to update RMD tables and address “certain other” RMD issues
- Regulations on withholding from periodic payments
- Regulations regarding IRAs
- Regulations on qualified plan loan offset amounts
- Finalize regulations on private annuities
- Finalize regulations on hardship distributions from qualified plans
- Guidance on the timing of amendments to section 403(b) plans