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Section 1016.—Adjustments to basis

Rev. Rul. 2020-05

ISSUE

After the amendment of § 1016(a) of the Internal Revenue Code (Code) by section 13521 of Public Law No. 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), what is the amount of A's and B's income recognized upon the sale of the life insurance contracts described in Situation 2 of Rev. Rul. 2009-13, 2009-21 I.R.B. 1029; Situation 3 of Rev. Rul. 2009-13; and Situation 2 of Rev. Rul. 2009-14, 2009-21 I.R.B. 1031?

LAW AND ANALYSIS

Sections 1011 and 1012 of the Code provide that the adjusted basis for determining gain or loss is generally the cost of property adjusted as provided in § 1016, except as otherwise provided in subchapters O (§§ 1011 through 1092), C (§§ 301 through 386), K (§§ 701 through 777), and P (§§ 1201 through 1298) of chapter 1 of the Code.

Section 1016(a) provides that proper adjustment must be made for expenditures, receipts, losses, or other items properly chargeable to capital account. Section 13521 of the TCJA amended § 1016(a) to provide that, in determining the basis of a life

insurance contract or an annuity contract, no adjustment is made for mortality, expense, or other reasonable charges incurred under the contract. See § 1016(a)(1)(B). This amendment is effective for transactions entered into on or after August 26, 2009 (the effective date of Rev. Rul. 2009-13 with respect to Situations 2 and 3).

Rev. Rul. 2009-13 and Rev. Rul. 2009-14 apply § 1016 (prior to its amendment by the TCJA) to determine the adjusted basis of life insurance contracts under §§ 1011 and 1012 in several factual situations.

In Situation 2 of Rev. Rul. 2009-13, A, an individual, entered into a life insurance contract with cash value on January 1 of Year 1. Under the contract, A was the insured, and the named beneficiary was a member of A's family. On June 15 of Year 8, A sold the contract to B, an unrelated person who would suffer no economic loss upon A's death, for \$80,000. Prior to the sale of the contract, A had paid \$64,000 in premiums. The cost of insurance charges collected by the issuer was \$10,000 as of the date of the sale. Situation 2 of Rev. Rul. 2009-13 provides that if a taxpayer holds a life insurance contract for purposes of insurance protection, it is necessary to reduce the taxpayer's basis in the contract by that portion of the premium paid for the contract that was expended for the provision of insurance before the sale in order to measure the taxpayer's gain upon the sale of the contract. Therefore, Situation 2 of Rev. Rul. 2009-13 provides that A must reduce A's basis in the contract by the cost of insurance. As a result, A's adjusted basis as of the date of the sale was \$54,000 (\$64,000 premiums paid less \$10,000 expended as cost of insurance). Because A sold the contract for \$80,000, Rev. Rul. 2009-13 holds with respect to Situation 2 that A must recognize

\$26,000 of income on the sale of the contract (\$80,000 amount realized less \$54,000 adjusted basis of the contract).

In Situation 3 of Rev. Rul. 2009-13, the contract was a level premium fifteen-year term life insurance contract without cash surrender value. The monthly premium for the term life insurance contract was \$500, A held the contract for 89.5 months, and A paid premiums totaling \$45,000 as of the date of the sale. A sold the contract for \$20,000 to B, an unrelated person who would suffer no economic loss upon A's death. Situation 3 of Rev. Rul. 2009-13 provides that A must reduce A's basis in the contract by the cost of insurance, which is presumed to equal the monthly premiums under the contract. A's adjusted basis in the contract as of the date of the sale was therefore \$250 (\$45,000 total premiums paid less \$44,750 cost of insurance protection). Because A sold the contract for \$20,000, Rev. Rul. 2009-13 holds with respect to Situation 3 that A must recognize \$19,750 of income on the sale of the term life insurance contract (\$20,000 amount realized on the sale less \$250 adjusted basis of the contract).

In Situation 2 of Rev. Rul. 2009-14, the facts are the same as in Situation 3 of Rev. Rul. 2009-13, except that B purchased the contract for \$20,000 from A and then, at the end of the following year, sold the contract to C, a person unrelated to either A or B, for \$30,000. Before selling the contract, B paid a total of \$9,000 in premiums. In Situation 2 of Rev. Rul. 2009-14, B, unlike A in Situation 3 of Rev. Rul. 2009-13, was not required to reduce B's basis by the cost of insurance because B was wholly unrelated to the insured, did not purchase the life insurance contract for protection against economic loss upon the insured's death, purchased the contract solely with a view to profit, and enjoyed no insurance protection from the contract. B's cost basis

was \$29,000, the sum of what B paid for the contract and the premiums B paid to keep the contract in force (\$20,000 purchase price plus \$9,000 in premiums). B's adjusted basis was \$29,000 (\$29,000 cost basis with no adjustment for cost of insurance), and B recognized \$1,000 of income on the sale of the contract to C (\$30,000 amount realized on sale less \$29,000 adjusted basis of the contract).

The analysis and holdings relating to A's adjusted basis in the contract in Situations 2 and 3 in Rev. Rul. 2009-13 and the analysis relating to B's adjusted basis in the contract in Situation 2 in Rev. Rul. 2009-14 are inconsistent with the language of § 1016(a)(1)(B), added to the Code by the TCJA. Under § 1016(a)(1)(B), the cost basis of a life insurance contract is not reduced by the cost of insurance, regardless of why the contract is purchased. Rev. Rul. 2009-13 and Rev. Rul. 2009-14 are therefore modified to the extent they are inconsistent with the rule set forth in § 1016(a)(1)(B).

In Situations 2 and 3 in Rev. Rul. 2009-13, under § 1016(a)(1)(B), as added by the TCJA, A is not required to reduce A's basis in the contract by the cost of insurance. Accordingly, in Situation 2 of Rev. Rul. 2009-13, A's adjusted basis in the contract equals the premiums paid. A must recognize \$16,000 of income on the sale of the contract (\$80,000 amount realized on sale less \$64,000 adjusted basis). In Situation 3 of Rev. Rul. 2009-13, A's adjusted basis in the contract equals the premiums paid. A will recognize a \$25,000 loss on the sale of the contract (\$20,000 amount realized on the sale less \$45,000 adjusted basis). A will not be permitted to deduct the loss unless the loss is incurred under § 165(c)(1) or (2).

In Situation 2 of Rev. Rul. 2009-14, B is not required to reduce B's basis in the contract by the cost of insurance because B was wholly unrelated to the insured, did not purchase the life insurance contract for protection against economic loss upon the insured's death, purchased the contract solely with a view to profit, and enjoyed no insurance protection from the contract. Under § 1016(a)(1)(B), as added by the TCJA, B is not required to reduce B's basis in the contract by the cost of insurance, regardless of why the insurance contract is purchased. Accordingly, the outcome for B in Situation 2 of Rev. Rul. 2009-14 does not change, but B's situation is no longer distinguishable from that of A in Situation 3 of Rev. Rul. 2009-13 with regards to the treatment of cost of insurance charges.

HOLDINGS

1. In Situation 2 of Rev. Rul. 2009-13, A recognizes \$16,000 of income upon the sale of the life insurance contract, of which \$14,000 is ordinary income, and \$2,000 is long-term capital gain.¹
2. In Situation 3 of Rev. Rul. 2009-13, A recognizes a long-term capital loss of \$25,000 upon the sale of the life insurance contract.
3. In Situation 2 of Rev. Rul. 2009-14, B recognizes \$1,000 of long-term capital gain upon the sale of the life insurance contract.

EFFECT ON OTHER DOCUMENTS

¹ Section 13521 of the TCJA only applies to determine a taxpayer's adjusted basis in a life insurance contract under § 1016. Section 13521 of the TCJA does not affect the analysis in Situations 2 and 3 of Rev. Rul. 2009-13 and Situation 2 of Rev. Rul. 2009-14 with respect to the character of any income or loss recognized by a taxpayer on the sale of a life insurance contract.

This revenue ruling modifies Rev. Rul. 2009-13 and Rev. Rul. 2009-14.

EFFECTIVE DATE

Consistent with the effective date of the TCJA amendment to § 1016(a), this revenue ruling is effective for transactions entered into on or after August 26, 2009. See § 7805(b)(8). A change in the internal revenue laws that is made retroactive to earlier taxable years does not automatically permit a claim for a refund for such a year when the claim is barred by the period of limitations. See *United States v. Zacks*, 375 U.S. 59 (1963). Congress did not amend the statute of limitations set forth in § 6511 or otherwise express an intent to waive or extend the period of limitations for the retroactive change made to § 1016(a) by section 13521 of the TCJA.

DRAFTING INFORMATION

The principal author of this revenue ruling is Megan McGuire of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. McGuire at (202) 317-6995 (not a toll-free number).