A QUICK REFERENCE TO ESTIMATE AFTER-TAX OUTCOMES FOR CLIENTS.

How Life Settlements Are Taxed.

Since the Tax Cuts and Jobs Act of 2017, life settlement taxation is often minor or non-existent. Three tiers determine treatment of the offer; in most cases, the taxable portion (if any) is long-term capital gains. **Always confirm with the client's tax advisor** — this reference is for planning conversations, not tax advice.

THE THREE TIERS OF TAX TREATMENT

01 COST BASIS

The portion of proceeds equal to total premiums paid into the policy.

TAX TREATMENT

Tax-free

02 CASH SURRENDER VALUE OVER COST BASIS

The portion of CSV that exceeds total premiums paid.

In practice, this is often $0 — most policies' CSV doesn't exceed cumulative premiums.

TAX TREATMENT

Ordinary income

03 GAIN OVER CASH SURRENDER VALUE

The portion of the offer that exceeds CSV (after subtracting cost basis from CSV).

TAX TREATMENT

Long-term capital gains

HYPOTHETICAL EXAMPLE

POLICY VALUES

Death benefit	$1,000,000
Life settlement offer	$450,000
Cost basis (premiums paid)	$350,000
Cash surrender value	$75,000

QUICK ESTIMATING HEURISTIC

If CSV is less than cost basis (the typical case), the only tax owed is LTCG on the gap between the offer and CSV. Multiply that gap by ~15–20% for a rough estimate (IRC §1(h)). Confirm with the client's tax advisor before presenting figures.

WHERE IT GETS COMPLEX

Trust-owned policies, prior partial withdrawals, MEC status, state-level tax, and §1016 basis adjustments can all change the math. Loop in the CPA before quoting numbers.

TAX CALCULATION

TIER 1: COST BASIS (TAX-FREE)

Cost basis recovered	$350,000

TIER 2: ORDINARY INCOME

CSV – Cost basis	$0
Ordinary income tax (32%)*	$0

TIER 3: LTCG

Offer – CSV (LTCG portion)	$100,000
Capital gains tax (15%)*	$15,000

AFTER-TAX NET TO CLIENT

$435,000

$450,000 offer – $15,000 estimated tax

*Tax rates shown are illustrative and vary by individual circumstances. This reference is not tax advice. Always consult a qualified tax professional for any specific transaction.

THE EXCEPTION WORTH KNOWING

Viatical exception — IRC §101(g)

Terminally ill (≤24 months): Proceeds generally excludable from gross income under IRC §101(g)(1) — physician certification required. **Chronically ill:** May qualify under IRC §101(g)(3), subject to per-diem limits (IRC §7702B(c)(2)). More restricted — confirm with CPA before representing **entirely income-tax-free** treatment.

QUESTIONS ON A SPECIFIC CASE?

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*Tax rates shown are illustrative and vary by individual circumstances. This reference is not tax advice. Always consult a qualified tax professional for any specific transaction. Citations: TCJA §13521(a), P.L. 115–97 (Dec. 22, 2017), codified at IRC §1016(a)(1)(B); IRS Rev. Rul. 2020-05; IRC §101(g); IRC §7702B(c)(2); IRC §1(h).