What is the income tax treatment of an amount received from a viatical settlement provider?

A viatical settlement provider is “any person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of insureds” who are terminally or chronically ill, provided that certain licensing and other requirements are met.[[1]](#footnote-1) To be considered a viatical settlement provider a person must be licensed for such purposes in the state in which the insured resides. The IRS has provided guidance on when viatical settlement providers will be considered licensed.[[2]](#footnote-2)

If any portion of a death benefit under a life insurance contract on the life of a terminally or chronically ill insured is sold or assigned to a viatical settlement provider, the amount paid for the sale or assignment will be treated as an amount paid under the life insurance contract by reason of the insured’s death.[[3]](#footnote-3) In other words, such an amount will not be includable in income.[[4]](#footnote-4)

A terminally ill individual is a person who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death within twenty-four months following the certification.[[5]](#footnote-5)

A chronically ill individual is a person who is not terminally ill and who has been certified by a licensed healthcare practitioner as being unable to perform, without substantial assistance, at least two activities of daily living (ADLs) for at least ninety days or a person with a similar level of disability. Further, a person may be considered chronically ill if the person requires substantial supervision to protect himself or herself from threats to his or her health and safety due to severe cognitive impairment and this condition has been certified by a healthcare practitioner within the previous twelve months.[[6]](#footnote-6) The activities of daily living are:

(1) eating;

(2) toileting;

(3) transferring;

(4) bathing;

What is the income tax treatment of an amount received from a viatical settlement provider?

(5) dressing; and

(6) continence.[[7]](#footnote-7)

If an insured resides in a state that does not require licensing of viatical settlement providers, the insured must meet the standards for either a terminally ill individual or a chronically ill individual.[[8]](#footnote-8) The requirements applicable to an insured who is a terminally ill individual are met if the person: (1) meets the requirements of Sections 8 and 9 of the Viatical Settlements Model Act of the NAIC, and (2) meets the requirements of the Model Regulations of the NAIC in determining amounts paid by such person in connection with such purchases or assignments.[[9]](#footnote-9) The requirements applicable to an insured who is a chronically ill individual are met if the person: (1) meets requirements similar to the requirements of Sections 8 and 9 of the Viatical Settlements Model Act of the NAIC, and (2) meets the standards of the NAIC for evaluating the reasonableness of amounts paid by such person in connection with such purchases or assignments with respect to chronically ill individuals.[[10]](#footnote-10)

**Planning Point: The term “viatical settlement” is technical in its definition that viatical settlements refer to only those cases where the insured under the policy is terminally ill. Where the insured is not terminally ill, the terminology of “high net worth transactions” or “senior settlements” may be more appropriate. Transactions involving senior settlements, rather than “viatical settlements” are not necessarily taxed in the same manner.**

1. IRC Sec. 101(g)(2)(B)(i). [↑](#footnote-ref-1)
2. Rev. Rul. 2002-82, 2002-2 CB 978. [↑](#footnote-ref-2)
3. IRC Sec. 101(g)(2)(A). [↑](#footnote-ref-3)
4. See IRC Sec. 101(a). [↑](#footnote-ref-4)
5. IRC Sec. 101(g)(4)(A). [↑](#footnote-ref-5)
6. IRC Secs. 101(g)(4)(B), 7702B(c)(2)(A). [↑](#footnote-ref-6)
7. IRC Sec. 7702B(c)(2)(B). [↑](#footnote-ref-7)
8. IRC Sec. 101(g)(2)(B). [↑](#footnote-ref-8)
9. IRC Sec. 101(g)(2)(B)(ii). [↑](#footnote-ref-9)
10. IRC Sec. 101(g)(2)(B)(iii). [↑](#footnote-ref-10)