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Are the proceeds from a life settlement taxable?

Just like the sale of other personal assets, the income generated from a life settlement transaction may be taxable. Life settlement transactions typically result in a capital gain. In rare circumstances, a portion of the settlement proceeds may be treated as ordinary income. This would only occur if the policy's cash surrender value were greater than the total cost of premiums paid into the policy. However, it is also possible that there are no federal tax consequences if the settlement proceeds are less than or equal to the adjusted basis in the policy.

Additionally, any tax implications for capital gains realized from a life settlement transaction could be offset by tax deductions based on "the entire cost of maintenance in a nursing home or home for the aged" (sec. 1016 U.S. Master Tax Code 2008). In the case of a viatical settlement where the insured has a terminal diagnosis with a certified physician's prognosis of 24 months or less, the proceeds may be tax-free at the federal level (see Health Insurance Portability and Accountability Act of 1996).

Crescent Life Settlements is not a tax advisor and strongly recommends that policy owners seek professional tax advice prior to accepting any life settlement offers.