

Office of Personnel Management
Retirement and Insurance Service



1920



1954



1959



1986

Benefits Administration Letter

Number: 96-206

Date: September 12, 1996

SUBJECT: Federal Employees' Group Life Insurance: Tax Treatment of Living Benefits and Viatical Settlements

Purpose

The purpose of this letter is to notify agencies of a change in the Federal income tax law affecting accelerated death benefits under the Federal Employees' Group Life Insurance (FEGLI) Program.

What are "accelerated death benefits"?

The term "accelerated death benefits" includes:

- the payments received through the Living Benefits provision of the FEGLI Program, and
- payments received from viatical settlement firms resulting from the assignment of FEGLI coverage.

Old tax provision

Under Federal income tax law affecting payments received during 1996 and earlier, Living Benefits payments and payments from viatical settlement firms are subject to Federal income tax.

New tax law

Under Public Law 104-191, the Health Insurance Portability and Accountability Act of 1996, Subtitle D, Treatment of Accelerated Death Benefits, Living Benefit payments and qualified payments from viatical settlement firms received after December 31, 1996, will not be subject to Federal income tax.

Effective date of new tax law

The new tax law affects payments received **after** December 31, 1996. It has **no** effect on payments received on or before that date.

What are "qualified payments from viatical settlement firms"?

The new tax law sets qualification standards for viatical settlement providers, terminally ill insured persons, chronically ill insured persons, and, in the case of chronically ill insured persons, how the payment may be spent. Since the Internal Revenue Service, not OPM, administers Federal income tax law, employees who are considering assigning their insurance to a viatical settlement firm should consult a competent tax advisor to determine if they and their viatical settlement firm meet the qualification standards. It is clear, however, that to be considered terminally ill, a person's life expectancy can be no more than 24 months.

Advice to employees

Employees may want to postpone their Living Benefits or viatical settlement payments until 1997 in order to take advantage of the change in the tax law. Therefore, it is important for employing offices to inform employees who want to elect Living Benefits or to assign their insurance to a viatical settlement firm that the tax law has changed. Employing offices should not attempt to give tax advice, but should advise employees to consult a tax advisor if the employee is interested in the tax savings that could result from postponing receipt of the payments.

Recognizing that prompt receipt of the payment may be more important to some terminally ill employees than a tax savings, agencies should not attempt to prevent them from promptly completing these transactions if that is their preference.

When is a payment considered to be received?

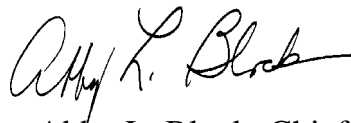
The determination of when a payment is considered to be received must be made by IRS, not OPM. However, in the case of Living Benefits, an employee may ensure that he or

she will not receive the payment before January 1, 1997, by waiting until at least mid-December before returning the claim form (FE-8) to the Office of Federal Employees' Group Life Insurance (OFEGLI). OFEGLI has begun informing employees who request an FE-8, Claim for Living Benefits, by including a copy of the attached notice when they send the claim form.

In the case of an assignment to a viatical settlement firm, the employee may request that the firm not make the payment before January 1, 1997.

Are State taxes affected?

This law amends the Federal Internal Revenue Code, which directly affects Federal income tax, not State taxes. However, many States have laws, regulations, or rulings concerning the taxability of accelerated death benefits. Many States use Federal adjusted gross income as a base for calculating income subject to State tax. Therefore, an employee's taxable income under State law may also be affected by the date these payments are received. Employees may consult a tax advisor, tax counsel, or their State's tax department for specific information concerning State income tax laws.



Abby L. Block, Chief
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Information Division

Attachment

Notice that OFEGLI is sending out with the FE-8, Claim for Living Benefits

NOTICE CONCERNING TAXATION AND WITHHOLDING

Under present law, Living Benefits are included in gross income for Federal tax purposes, as well as most state tax purposes.

However, Living Benefits received after December 31, 1996 will be excluded from gross income for Federal tax purposes. (Section 331 of the Health Insurance Portability and Accountability Act of 1996.)

If you want to be certain that you will not have any Federal income tax liability from Living Benefits, you should not submit this claim form until mid-December. This will ensure that you will not receive Living Benefits until after December 31, 1996, and therefore the payment will not be subject to Federal income tax. In addition, if you wait until mid-December to submit this form, you should not complete Part A, Item 11 on the claim form (FE-8) because Living Benefits payment made after December 31, 1996, will not be subject to Federal tax withholding.

If you need the money earlier, feel free to submit your claim form at any time. However, please note that you will be subject to Federal income tax on any amount received on or before December 31, 1996. In January of 1997 we will send you a Form 1099-R reporting the amount of Living Benefits that you received. This information will also be reported to the Internal Revenue Service (IRS). In addition, any payment you receive on or before December 31, 1996, will be subject to Federal income tax withholding unless you elect not to have withholding apply.

You may elect not to have withholding apply to your distribution by checking the box in Part A, Item 11 on the claim form (FE-8). If you do not check the box, Federal income tax will be withheld at a rate of 10 percent.

If you elect not to have withholding apply, or if you do not have enough withheld, you may be responsible for payment of estimated tax. You may incur penalties under the estimated tax rules if your withholding and estimated tax payments are not sufficient.

The new law amends Section 101 of the Internal Revenue Code which is the law for Federal income tax purposes. Some states have issued specific laws, regulations and rulings concerning the taxability of accelerated death benefits (the generic name for FEGLI Living Benefits). Many states use Federal adjusted gross income as a base for calculating income subject to state tax. Since FEGLI Living Benefits received after December 31, 1996, will be excluded from Federal adjusted gross income, state taxable

income could be affected as well. You should consult your tax advisor, tax counsel, or State tax department for more information concerning your liability for state income tax on FEGLI Living Benefits. The new law requires the reporting of accelerated death benefits to the IRS and the recipients of FEGLI Living Benefits on a form to be prescribed by the IRS.