Life Insurance Proceeds and Estate Tax

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Estate Tax is a tax on the right of the deceased person to transmit his estate to his lawful heirs and beneficiaries at the time of death and on certain transfers, which are made by law as equivalent to testamentary disposition. It is not a tax on property. It is a tax imposed on the privilege of transmitting property upon the death of the owner. The Estate Tax is based on the laws in force at the time of death notwithstanding the postponement of the actual possession or enjoyment of the estate by the beneficiary. The tax is imposed upon the net estate, which is the gross estate less the deductions. Family homes that are worth up to P10 million are now exempted from estate tax.

The gross estate consists of all properties (real or personal, tangible or intangible) owned by a decedent at the time of his death. However, it shall not include the separate properties of the surviving spouse. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated. Provided, that in case of a non-resident decedent who at the time of his death was not a citizen of the Philippines, only that part of his entire gross estate which is situated in the Philippines shall be included in his taxable estate (Section 85, NIRC).

Will the life insurance proceeds be included in the gross estate and therefore be subject to estate tax? The answer will depend on who the beneficiary of the insurance policy is. Under Section 85(E) of the National Internal Revenue Code, proceeds from life insurance shall be included in the computation of the Gross Estate of the deceased when the beneficiary is the estate, executor or administrator, whether or not the designation is revocable or irrevocable, and when the beneficiary is other than the estate, executor or administrator, and the designation is revocable. These are the only two instances when life insurance proceeds are subject to estate tax.

If the policy does not expressly say that the designation of the beneficiary is irrevocable, then it is presumed to be revocable. However, if the beneficiary was never replaced during the lifetime of the insured, then the designation shall be deemed irrevocable (Section 11 of the Insurance Code), and therefore tax-exempt.

On the other hand, the proceeds from the life insurance shall not be included in the computation of the Gross Estate when the beneficiary is other than the estate, executor or administrator, and the designation is “expressly stipulated” to be irrevocable. In this instance, it becomes tax-free. It is the only instance when life insurance proceeds are exempt from estate tax. Hence, designating your heirs as the irrevocable beneficiary exempts the proceeds from estate tax. It is, therefore, the wiser move. The downside is, of course, that you have given up the flexibility in choosing your beneficiary. The beneficiary can only be replaced upon the consent of the irrevocable beneficiary. The life insurance proceeds can also address the payment of the estate tax as liquidity upon the death of the decedent is a usual issue among the heirs. Incidentally, proceeds or benefits from the SSS (R.A. No. 1792) and GSIS (R.A. No. 728) are also not subject to estate tax. Also, proceeds of life insurance under a group insurance taken by the employer are not subject to estate tax.

The estate tax return must be filed within one year from the death of the decedent. The Commissioner of Internal Revenue may extend the filing by a period not exceeding 30 days in meritorious cases. The tax is paid upon the filing of the return. The Commissioner may, however, extend the payment of the tax for two years in case of extrajudicial settlement of the estate if the payment of the tax will bring undue hardship to the heirs. If the decedent dies with a last will and testament, the Commissioner of Internal Revenue may extend the payment to five years.

Prior to the amendment of our tax laws, the estate tax ranged from 5% to 20% of the net estate (Section 84 of NIRC). With the new tax reform under Republic Act No. 10963, otherwise known as the Tax Reform for Acceleration and Inclusion (TRAIN), the estate tax is now flat rate of 6% (Section 22 of TRAIN Law).

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