



IRS Provides Guidance on Employer-Owned Life Insurance After PPA

The IRS has issued a notice providing guidance on the new tax rules added by the Pension Protection Act of 2006 for employer-owned life insurance contracts.

Background

The Pension Protection Act of 2006 (PPA) added Section 101(j) to the Internal Revenue Code, revising the taxation of employer-owned life insurance contracts. In general, only the amount of death benefits equal to the premiums paid by the employer will be tax-free upon the insured's death. However, if the employer notifies and obtains consent of the individual to be insured, the restriction on the tax exclusion will not apply with respect to certain highly-compensated and other employees, when the death proceeds are paid to a family member or trust, or when such proceeds are used to purchase an equity interest in the employer. An employer-owned life insurance contract is defined as one owned by "a person engaged in a trade or business" (i.e., the employer), under which the employer is the beneficiary, and which covers the life of an employee on the date the contract is issued.

PPA also added a new IRS reporting requirement under Section 6039I for employer-owned contracts issued after August 17, 2006. Last year, the IRS issued final regulations on this new requirement. (See our November 17, 2008 [For Your Information](#).) The IRS has now issued Notice 2009-48, which provides additional guidance on employer-owned contracts after PPA.

BUCK COMMENT. *Section 101(j) applies to employer-owned life insurance contracts broadly, not just corporate-owned life insurance (COLI) that has often been used to finance nonqualified deferred compensation liabilities. Employers need to be aware that the annual filing requirements extend to other employer-owned arrangements such as key person life insurance.*

Notice 2009-48

In question and answer format, [Notice 2009-48](#) provides the following guidance.

Employer-Owned Contracts

In defining an employer-owned contract, the guidance indicates –

- A contract that is owned by a related person who is not engaged in a trade or business (e.g., for a buyout of another owner), a qualified plan, or VEBA is not an employer-owned contract. However, a contract owned by a grantor trust, such as a “Rabbi trust,” is an employer-owned contract.
- A contract under a split-dollar arrangement can be an employer-owned contract except to the extent death proceeds are paid to a family member or trust.
- A contract is generally considered “issued” on the date assigned by the insurance company, but special rules apply for purposes of the notice and consent requirements.
- A contract can be considered newly issued as a result of a material change in the contract (e.g., an increase in the death benefit).

Exemption Requirements

With regard to the requirements for exemption from the general rule of taxation, the guidance indicates –

- If the life insurance proceeds are used to purchase an equity interest in the applicable policyholder, it must be done by the policyholder’s tax return due date (including extensions) for the year in which the proceeds are received.
- The notice and consent requirements apply to the owner-employee of a wholly-owned corporation.
- Notice and consent are not required with respect to an employee’s irrevocable transfer of an existing life insurance contract to an employer.
- For consent to be valid, the contract must be issued within one year after the consent was executed or by the employee’s termination date, whichever is earlier. A single consent may apply to more than one employer-owned contract, as long as the notice and consent requirements are met.
- The notice and consent requirements may be satisfied electronically under specified circumstances.
- Adequate notice requires that the face amount of life insurance be disclosed either in dollars or a multiple of salary. It is not sufficient to indicate that the amount is “the maximum face amount for which the employee could be insured.”
- If failures to satisfy the notice and consent requirements are inadvertent, the exemption may still apply under specified conditions.

Transition Rule and Section 1035 Exchanges

The new rules apply to contracts issued after August 17, 2006 other than a contract exchanged under Section 1035 for a contract issued on or before that date. However, if there is a material increase in the death benefit or other material change in the new contract, the materially revised contract will be subject to the new rules.

Material changes for this purpose do not include –

- death benefit increases to meet Section 7702 or the contract's terms
- administrative changes
- changes from general account to separate account or vice versa
- changes resulting from the exercise of a right or option granted under the original contract.

If a contract is received after August 17, 2006 in a valid Section 1035 exchange, no further notice and consent are generally required.

Information Reporting

For purposes of filing the information return, the notice clarifies that generally only one taxpayer is required to file Form 8925 with respect to an employer-owned contract. The applicable policyholder "owning 1 or more employer-owned life insurance contracts" that is required to file is generally the owner of the employer-owned contract and not any related persons.

Effective Date

The notice is effective June 15, 2009 and the IRS will not challenge any good faith efforts to comply based on a reasonable interpretation before that date.

Conclusion

The notice provides some clarifications that will be useful for those companies with employer-owned life insurance contracts. Buck's consultants are available to discuss this guidance or any other issues regarding these types of contracts.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.