

Tax *Flash*

Information Reporting for Employer-owned Life Insurance Contracts

It is not unusual for a business to acquire insurance on the life of an employee. Often, this occurs to provide a source of funds to buy-out the equity of an employee-owner in the event of an untimely death. In other cases the insurance is key person protection. In the past, life insurance death benefits have been tax free if collected by an employer. But new tax law and IRS regulations threaten this exemption in some cases.

The IRS recently issued regulations (Reg. §1.6039I-1) that require employers to file a tax schedule disclosing information on employer-owned life insurance contracts (“EOLI contracts”). An EOLI contract is a life insurance contract issued after August 17, 2006, that is owned by an employer engaged in a business who is a beneficiary of the policy and which insures the life of an employee. The regulations apply to tax years ending after November 6, 2008.

The regulations relate to a change in the tax code that occurred in 2006. Under this law, the death benefits from an EOLI contract in excess of premiums paid represent taxable income *unless* the employer complies with certain notice and consent requirements (IRC §101(j)(2)). Life insurance death benefits remain tax-free if the employer notifies and secures the written consent of the employee to the insurance company prior to placement of the policy, and the policy is for a typical business need such as key person protection or funding a buy-sell agreement.

In addition, every employer owning one or more EOLI contracts issued after August 17, 2006, must file a return with the IRS on Form 8925, “Report of Employer-Owned Life Insurance Contracts.” This form discloses the status of the EOLI policies owned by the employer.

The new IRS regulations address only the information reporting on Form 8925. They do not address the requirement under IRC §101(j)(2) that an employer must notify and secure the employee’s written consent *prior to* the issuance of any EOLI policy issued after August 17, 2006 in order to receive tax-free death benefits. The IRS is considering publishing guidance that will address these requirements.

In the interim, employers who obtain new EOLI contracts should be certain to comply with the employee notice and consent requirements of the new law. Employers who maintain EOLI contracts issued after August 17, 2006, without the proper consent may wish to document that their employees have since been notified and consent to the EOLI contracts (although there is not yet any guidance by the IRS that such documentation will constitute acceptable notice and consent). Alternatively, they should consider exchanging the old EOLI contracts for new EOLI contracts after complying with the new notice and consent requirements.

If you have an EOLI that qualifies please be sure to let us know for return preparation. If you have any questions on these rules please do not hesitate to call us at 330-453-7633.