

## **New Hurdles for Employers Who Obtain New Corporate Owned Life Insurance**

Lorman  
By Riker Danzig  
October 30, 2006

The Pension Protection Act of 2006 includes new rules applicable to employers who obtain life insurance policies, also known as corporate owned life insurance (COLI) on the lives of one or more of its employees. Under the new rules, the following requirements must be satisfied if the employer desires to exclude the policy proceeds from its income upon the death of the employee. Failure to satisfy the requirements will result in the policy proceeds being included in the employer's income (except to the extent of the premiums paid by the employer). These new rules apply broadly to most corporate owned life insurance policies, including policies that are owned by and payable to the employer to fund deferred compensation payments or to fund equity redemptions at the death of the insured. The rules also apply to policies that are owned by an employer where the death benefit is payable to a designated beneficiary (although it is not clear how the rules would apply in that situation).

First, the insured individual must be either (i) an employee at any time during the 12-month period prior to his or her death, or (ii) a director or highly compensated individual (generally, among the highest paid 35% of employees) at the time the policy was issued.

Second, before the issuance of the policy, the employer must provide written notice to the employee that sets forth (i) the employer's intent to insure the employee, (ii) the maximum face amount for which the employee could be insured, and (iii) that the employer will be a beneficiary of the policy proceeds upon the employee's death.

Third, the employee must provide written consent to being insured and that the coverage may continue after the employee terminates employment.

Fourth, the employer must file an annual return with the Internal Revenue Service reporting (i) the number of employees of the employer at the end of the year, (ii) the number of employees insured under COLI policies at the end of the year, (iii) the total amount of insurance in force at the end of the year under the COLI policies, (iv) the employer's name, address, taxpayer identification number and type of business in which it is engaged, and (v) a statement that the employer has a valid consent from each insured employee (or the number of insured employees for whom consent was not obtained).

Fifth, the employer must keep any records that may be necessary to verify compliance with the new COLI rules.

If the notice and consent requirements are satisfied, policy proceeds will be excluded from the employer's income to the extent they are paid to (i) a family member of the employee, (ii) a designated

## The Clarke School

---

beneficiary of the employee (other than the employer), (iii) a trust established for the benefit of any such family member or designated beneficiary, or (iv) the employee's estate. In addition, if the notice and consent requirements are satisfied, the policy proceeds will be excluded from the employer's income to the extent the proceeds are used to purchase an equity interest in the employer from the employee's family member or designated beneficiary (or trust for their benefit) or the employee's estate.

The new rules apply to policies issued after August 17, 2006. Therefore, the above requirements, including the filing of an annual return, do not apply to pre-existing COLI policies. Also, if a policy issued before August 17, 2006 is exchanged for a policy issued after August 17, 2006 pursuant to a tax-free Code Section 1035 exchange, it will generally not be treated as a new policy and will not be subject to the new rules, unless there is a material change to the policy (such as a material increase in the death benefit).

The material appearing in this web site is for informational purposes only and is not legal advice. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. The information provided herein is intended only as general information which may or may not reflect the most current developments. Although these materials may be prepared by professionals, they should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

The opinions or viewpoints expressed herein do not necessarily reflect those of Lorman Education Services. All materials and content were prepared by persons and/or entities other than Lorman Education Services, and said other persons and/or entities are solely responsible for their content.

Any links to other web sites are not intended to be referrals or endorsements of these sites. The links provided are maintained by the respective organizations, and they are solely responsible for the content of their own sites.

<http://www.lorman.com/resources/new-hurdles-for-employers-who-obtain-new-corporate-owned-life-insurance-15578>