Be advised: Enforcement of EOLI compliance has intensified

Business Planning Newsletter **July 2009**

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Dear Bob,

The Internal Revenue Service is stepping up its pursuit of companies who fail to comply with rules regarding the treatment of certain employer-owned life insurance (EOLI) contracts.

IRS Notice 2009-48 announced June 15 as the date when the Service intensified its enforcement of EOLI contracts. This newsletter provides background on EOLI contracts and provides guidelines for filing and other requirements of employer-owned life insurance.

After reviewing it, please call us to further discuss how your company can best respond to the IRS announcement.

Best Regards,

The attorneys at McShane & Bowie

Background on EOLI and the events leading to the IRS notice

Employer-owned life insurance policies (those policies purchased and owned by a company on its employee with the company as the beneficiary -- and sometimes referred to as corporate-owned life insurance or COLI) earned a "bad name" in 2002 when media and the public began referring to the policies as "dead peasant's insurance" or "janitor's insurance."

The negative interpretations of employer life insurance were derived from employer abuse of policies. Employers would insure many or all of their non-key employees -- those who are not a director or a highly-compensated employee. Additionally, employers were purchasing life insurance on rank-and-file employees without their consent or knowledge -- where the death benefit would be payable to the employer. Death benefits received by employers abusing EOLI policies were tax-exempt and did not have to be annually reported.

In 2006, Congress introduced the EOLI Best Practices Act as part of the Pension Protection Act. In the case of an employer-owned life insurance contract issued after August 17, 2006, the amount of death benefits received by the employer is considered as ordinary income beyond the amount of premiums paid by the employer if certain requirements are not met. However, the amount of death proceeds may be fully tax-excluded, if the insurance contract meets notice and consent requirements and exception rules (see next section).

An IRS Notice was issued May 22, 2009 to provide guidance regarding the requirements of corporate-owned life insurance contracts falling under EOLI Best Practices. On June 15, 2009 the Notice became effective. The IRS assures they will not challenge taxpayers who made a good faith effort to comply with the practices based on a reasonable interpretation of the provisions before the effective date.

Companies can enjoy tax-exempt status on the life insurance payout by following important procedures

Notice and Consent Requirements

Before an EOLI contract is issued, three elements must be met.

- The employee must be notified in writing that the employer intends to insure the employee's life. The notice must set forth the maximum face amount for which the employee could be insured at the time the contract was issued.
- The employee must provide written consent to being insured under the contract and that coverage must continue after the employee terminates employment.
- The employee must be informed in writing that the employer will be a beneficiary of any death benefits.

Applicable Exceptions

If the notice and consent requirements are met and one or more of the following exceptions apply, the death proceeds will be income tax-free.

- The insured was an employee within the 12 months preceding death.
- The insured was a director or highly-compensated employee.

- The proceeds of the insurance contract are paid to a family member, designated beneficiary, a trust established for any family member or designated beneficiary, or the employee's estate.
- The proceeds of the insurance contract are used to purchase equity in the employer from anyone described above.

Reporting

Employers with one or more life insurance contracts must report the following annually to the IRS:

- The number of employees at the end of the year.
- The number of such employees insured under such contracts at the the end of the year.
- The total amount of insurance in force under such contracts.
- The employer's name, address, taxpayer identification number and a description of the type of business in which they engage.
- Valid consent for each insured employee.

To prove these conditions are met, the employer must retain documentation throughout the year.

Need more information to be be certain you're in compliance with EOLI requirements and reporting?

Do you want to be certain you are following the enhanced requirements regarding employer-owned life insurance?

There are more details concerning the notice and consent requirements, contract ownership, material changes and information reporting.

Call Nathan R. VanRyn at 732-5000 for complete information.   To learn more about Nathan and all of the attorneys at McShane & Bowie, visit www.msblaw.com.