

Bill Boersma - Blog

What is IRC Section 101(j)?

I am writing about this 2006 law today because, from my perspective and through personal experience, I do not see very many insurance and professional advisors talking with their clients about this issue. The potential downside in terms of unexpected taxation could make for a nasty surprise which your clients would almost assuredly blame you for.

The Pension Protection Act of 2006 (enacted August 17, 2006) includes new rules on employer owned life insurance that are effective for all new policies issued after the date of enactment. They effectively limit employer or corporate owned life insurance (EOLI or COLI) to highly compensated individuals and require the consent of the insured. The new rules under PPA have been incorporated into the provisions of Sections 101(j) and 6039I of the Internal Revenue Code.

Given these rules, unless these COLI policies meet the notice and consent provisions the death benefit on such a policy will be included in the employer's income in excess of premiums and other amounts paid on the contract.

Following are the specific requirements under the Section:

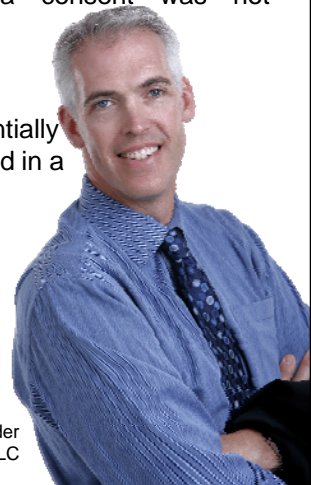
1. Notice – The employee must receive written notice of the policy, the maximum death possible face amount of the policy and that the employer will be the beneficiary of the policy death benefit.
2. Consent – The employee must provide written consent to being insured even after he/she terminates employment.
3. Exceptions – If the notice and consent requirements are met before the policy is issued and the insured falls into one of the following categories at the time the policy is issued, then the death benefit proceeds received by the employer will be income tax free.
 - a) Insured is an employee at any time during the 12 months preceding his/her death
 - b) Insured is a director or among the highest paid 35% of all employees as defined in IRC Section 105(h)(5)
 - c) Insured is a highly compensated employee as defined by IRC Section 414(q)

4. Exceptions for Family Beneficiaries and Stock Redemption – The exception is valid if the notice and consent requirements are met before the policy is issued and the death benefit is paid to:
 - a) A member of the insured's immediate family, to the insured's designated beneficiary under the policy, to a trust for the benefit of a family member or designated beneficiary or to the estate of the insured
 - b) Used to purchase an equity interest from a family member, beneficiary, trust or estate
5. Employer Reporting and Recordkeeping Requirement – Under IRC Section 6039I, employers who own one or more COLI contracts issued after August 17, 2006 are now required to file a return with the IRS for each year the contracts are owned. The return must state:
 - a) The number of employees at the end of the year
 - b) The number of employees insured under COLI contracts at the end of the year
 - c) The total amount of insured in force under the COLI contracts at the end of the year
 - d) The employer's name, address and taxpayer ID# and the employer's business
 - e) That the employer has a valid consent form for each employee and the number of insured employees from whom a consent was not obtained.

Potential Impact

The provisions of Section 101(j) will potentially impact life insurance policies that are used in a variety of employee benefit and business planning arrangements, including nonqualified deferred compensation, key person insurance, some buy-sell arrangements, some split dollar arrangements, Section 457(f) plans and bank owned life insurance.

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