important information regarding

Employer-Owned Life Insurance*

(Non-New York and Non-Washington Employers)

Federal tax legislation has created notice and consent requirements for employer-owned life insurance ("EOLI"). **Failure to satisfy these requirements can result in loss of income tax-free treatment of the policy's death benefit**. The following generally describes these requirements, as well as a reporting requirement contained in the federal legislation. All clients need to consult their legal counsel to ensure that they comply with all legal requirements related to life insurance they purchase on employees.

Definition of EOLI

Internal Revenue Code ("Code") Section 101(j) defines EOLI as a life insurance contract which:

- Is owned by a person engaged in a trade or business (an "employer") and under which the employer or a related person (collectively, the "applicable policyholder") is directly or indirectly a beneficiary under the contract and
- Covers the life of an insured who is an employee with respect to the applicable policyholder on the date the contract is issued.

Please note the following about this definition:

- First, although it does not clarify when an employer is deemed to "own" a policy, it appears that the employer must be formally designated as the policy owner. That is, it appears that just having an economic interest in the policy would not be considered ownership (otherwise, the second requirement requiring that the employer or a related person be a beneficiary under the contract would be unnecessary).
- Under this definition, for a contract to be considered an EOLI contract, the applicable policyholder must have an interest in the policy. Accordingly, contracts where the entire death benefit will be paid directly to heirs of the employee should not be considered EOLI contracts.

Notice and Consent Requirements (Required before the policy is issued)

Generally, Code Section 101(j) provides that, in the case of an EOLI contract, the applicable policyholder's portion of the death benefit (less premiums paid by the applicable policyholder) is taxable unless notice and consent requirements are met *and* one of the following exceptions applies:

- **Recent Employees**
  The insured was an employee of the applicable policyholder at any time during the 12-month period before death.
- **Directors and Highly Compensated Employees**
  At the time the contract was issued, the insured was:
  - ☐ A director of the applicable policyholder, or
  - ☐ A highly compensated employee of the applicable policyholder. For this purpose, a "highly compensated employee" for any year generally includes an employee who:
    - At any time during the year or preceding year was a 5% owner;
    - Had compensation for the preceding year in excess of the dollar limit in Internal Revenue Code Section 414(q) (For example, this amount is $110,000 for 2010. This amount is subject to change on an annual basis); or
    - Is among the highest paid 35% of employees
- **Amounts Paid to Heirs**
  The applicable policyholder's portion of the death benefit is:
  - ☐ Paid to a family member of the insured,
  - ☐ Paid to an individual who is a designated beneficiary of the insured (other than the employer or a related entity),
  - ☐ Paid to a trust for the benefit of any such family member or designated beneficiary,
  - ☐ Paid to the estate of the insured or
  - ☐ Used to purchase an equity (or partnership capital or profits) interest in the applicable policyholder from such a family member, beneficiary, trust or estate.

**For the purpose of this form, the term employer refers to the actual employer or a "related person" as described in IRC Section 101(j)(3)(B)(ii)*

redefining / standards AXA

Note that, although Code Section 101(j) does not specify when the applicable policyholder's portion of the death benefit must be paid or used as above, the legislative history indicates that it should be paid or used by the due date of the tax return for the taxable year of the applicable policyholder in which the death benefit is received.

Thus, unless the notice and consent requirements are met in a timely fashion, and the contract meets one of the above exceptions, the portion of the death benefit received by the applicable policyholder will only be excludable from gross income to the extent of premiums and other amounts paid. Under the notice and consent requirements, **before the issuance of the contract**, the employee must:

- Be notified in writing of the applicable policyholder's intent to insure his/her life and the maximum face amount for which the employee could be insured at the time the contract is issued,
- Provide written consent to being insured under the contract and to such coverage continuing after he/she terminates employment and
- Be informed in writing that the applicable policyholder will be a beneficiary of any proceeds payable upon the death of the employee.

Reporting Requirements

Code Section 6039I imposes certain reporting requirements on every applicable policyholder who owns EOLI contracts. Effective for tax years ending November 13, 2007, policyholders are required to file IRS Form 8925 with their return to the IRS for each year the contracts are owned.
The form requires:

- The number of their employees at the end of the tax year,
- The number of such employees that are insured under EOLI contracts at the end of the tax year by policies issued after August 17, 2006,
- The total amount of insurance in force at the end of the tax year under such contracts,
- The name, address and taxpayer identification number of the applicable policyholder and the applicable policyholder's type of business and
- That the applicable policyholder has a valid consent for each insured employee (or, if such consents are not obtained, the number of insured employees for whom such consent was not obtained). Consent generally expires one year after execution by the employee or earlier on termination of employment. The policy must be issued before consent expires.

Effective Date

The above rules generally apply to life insurance contracts issued after August 17, 2006, with a possible exception for certain contracts issued pursuant to an Internal Revenue Code Section 1035 exchange. Note, however, that material increases in the death benefit or other material changes will generally cause an existing contract to be treated as a new contract that may be subject to the above rules. Such changes will also cause an insured's status to be re-determined and notice and consent generally renewed.

Circular 230 Disclosure: Please be advised that this document is not intended as legal or tax advice. In addition, U.S. Treasury Regulations require us to inform you that "any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor."

Cat. #137310 (8/10)