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Subject: **Reminder That COLI is Subject to Notice and Consent and Annual Filing Requirements - Code sections 101(j) and 6039I**

Major References: [*IRS Form 8925 and Instructions*](#)

Prior AALU Washington Reports: 10-26; 09-56; 08-102; 08-22

MDRT Information Retrieval Index Nos.: 2400.00; 4400.05

SEE THE CIRCULAR 230 DISCLAIMERS APPENDED TO THE CONCLUSION OF THIS WASHINGTON REPORT.

This is a reminder that employer-owned life insurance contracts, more commonly referred to as corporate-owned life insurance or COLI, are subject to notice and consent requirements (as well as other requirements) and annual filing requirements with the Internal Revenue Service. (See our Bulletins Nos. 10-26; 09-56; 08-102; and 08-22.) If the notice and consent requirements are not satisfied before an employer-owned life insurance contract is first issued, any death proceeds paid under the contract generally are not excludible under Revenue Code section 101(a). Because the consequences of noncompliance are so harsh (i.e., taxable death benefits), it is generally advisable to comply with these requirements (as well as others) whenever there is a reasonable possibility that an arrangement may constitute an employer-owned life insurance contract. In addition, the annual filing requirements are satisfied by attaching an IRS Form 8925 to the policyholder's income tax return for each tax year during which the policyholder has employer-owned life insurance contracts in force.

Background

Section 101(j) provides that the death proceeds paid on an "employer-owned life insurance contract" will remain tax-free under section 101(a) if the statutorily prescribed notice and consent requirements are satisfied and the contract fits within one of the statutorily designated coverage conditions, which are: (i) the insured was an employee of the policyholder during the 12-month period before the insured's death, or (ii) at the time the contract was issued the insured was a director, or a highly compensated employee or individual.

An "employer-owned life insurance contract" is a life insurance contract which (i) is owned by a person engaged in a trade or business and under which such person (or related person) is directly or indirectly a beneficiary, and (ii) covers the life of an insured who is an employee with respect to the trade or business of the applicable policyholder on the date the contract is issued. The term "related person" is defined to include any person who (a) bears a relationship specified in sections 267(b) or 707(b)(1); or (b) is engaged in trades or businesses with such person which are under common control within the meaning of section 52(a) or (b). The term "employee" includes officers, directors and highly compensated employees. The broad nature of these terms raises questions of the extent to which section 101(j) applies to various types of arrangements (e.g., key man life insurance, split-dollar arrangements, and life insurance contracts held in Rabbi trusts). (See our Bulletin No. 08-22.)

In May 2009, the Revenue Service issued Notice 2009-48, which provides sections 101(j) and 6039I guidance in the form of seventeen questions and answers, which are divided into five separate categories - (i) the definition of an employer-owned life insurance contract, (ii) exceptions to the application of section 101(j), (iii) satisfaction of the notice and consent requirements, (iv) transition rules and section 1035 exchanges, and (v) information reporting requirements under section 6039I and IRS Form 8925. (See our Bulletin No. 09-56.)

Section 101(j) applies to contracts issued after August 17, 2006, except for one issued after that date pursuant to a section 1035 exchange for a contract issued on or before that date. For this purpose, any material increase in the death benefit or other material change causes the contract to be treated as a new contract and, thus, subject to section 101(j).

Notice and Consent Requirements

The notice and consent requirements are satisfied only if, before the issuance of the policy, the employee:

- (i) is notified in writing that the applicable policyholder intends to insure the employee's life and of the maximum face amount for which the employee could be insured at the time the contract was issued;
- (ii) provides written consent to being insured under the contract and that such coverage may continue after the insured terminates employment; and
- (iii) is informed in writing that an applicable policyholder will be a beneficiary of any proceeds payable upon the death of the employee.

Although the statute does not authorize the correction of inadvertent notice and consent failures, in Notice 2009-48 the IRS indicated that it would not challenge an inadvertent failure to satisfy the notice and consent requirement if the following conditions are met:

- (a) the applicable policyholder made a good faith effort to satisfy those requirements, such as by maintaining a formal system for providing notice and securing consents from new employees;
- (b) the failure to satisfy the requirement was inadvertent; and
- (c) the failure to obtain the requisite notice and consent was discovered and corrected no later than the due date of the tax return for the taxable year of the applicable policyholder in which the employer-owned life insurance contract was issued.

However, an inadvertent notice and consent failure cannot be corrected after the insured employee has died. Therefore, policyholders should develop policies and procedures to ensure compliance and to periodically review their operations in order to be able to correct any such inadvertent failures within the applicable time limits.

Annual Filing Requirements - IRS Form 8925

Section 6039I and IRS Form 8925 require that every applicable policyholder owning one or more employer-owned life insurance contracts issued after August 17, 2006 (or issued before then, but materially changed thereafter), provide the following information showing for each year the contracts are owned:

- (i) the number of employees of the applicable policyholder at the end of the year;
- (ii) the number of such employees insured under such contracts;
- (iii) the total amount of insurance in force at the end of the year under such contracts;
- (iv) the name, address, and identifying number of the applicable policyholder and the type of business in which the policyholder is engaged; and
- (v) a statement that the applicable policyholder has a valid consent for each insured employee or, if all such consents are not obtained, the number of employees for whom such consent was not obtained.

The Form 8925 is filed by attaching it to the policyholder's income tax return for each tax year during which the policyholder has employer-owned life insurance contracts in force. The Form 8925 is not required to be filed for any tax year ending before November 14, 2007. Thus, for calendar year taxpayers, a Form 8925 was not required to be filed until the 2007 year.

If a required return was not filed for a prior year, the potential consequences and the options, if any, for correcting such a missed filing are not clear. There do not appear to be any direct statutory monetary penalties for not filing a Form 8925. In addition, the instructions to Form 8925 do not discuss any penalties. Alternatively, the IRS may argue that certain failure to file penalties do apply. For example, because the Form 8925 is required to be attached to the policyholder's income tax return, the Service could contend that the income tax return is not complete until a required Form 8925 is attached.

Based on informal and nonbinding discussions with one of the drafters of IRS Notice 2009-48, AALU understands that the Service has been known to encourage taxpayers to file late returns in the effort to avoid any penalties that would otherwise be imposed for a non-filed Form 8925. However, because of the lack of formal guidance on this issue, each policyholder should make decisions respecting the late filing of a Form 825 only after consulting with his or her legal counsel.

Any AALU member who wishes to obtain a copy of IRS Form 8925 and instructions may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

In order to comply with requirements imposed by the IRS which may apply to the *Washington Report* as distributed or as re-circulated by our members, please be advised of the following:

THE ABOVE ADVICE WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, BY YOU FOR THE PURPOSES OF AVOIDING ANY PENALTY THAT MAY BE IMPOSED BY THE INTERNAL REVENUE SERVICE.

In the event that this *Washington Report* is also considered to be a “marketed opinion” within the meaning of the IRS guidance, then, as required by the IRS, please be further advised of the following:

THE ABOVE ADVICE WAS NOT WRITTEN TO SUPPORT THE PROMOTIONS OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED BY THE WRITTEN ADVICE, AND, BASED ON THE PARTICULAR CIRCUMSTANCES, YOU SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR.



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