

Part III - Administrative, Procedural, and Miscellaneous

Treatment of Certain Employer-Owned Life Insurance Contracts

Notice 2009-48

PURPOSE

This Notice provides guidance concerning the treatment of employer-owned life insurance contracts under §§ 101(j) and 6039I of the Code in a question and answer format. Sections 101(j) and 6039I were added to the Code by § 863 of the Pension Protection Act of 2006 (“PPA”), Pub. L. No. 109-280, 120 Stat. 780.

BACKGROUND

Section 101(j)(1) provides that, in the case of an employer-owned life insurance contract, the amount excluded from gross income of an applicable policyholder under § 101(a)(1) shall not exceed an amount equal to the sum of the premiums and other amounts paid by the policyholder for the contract. In general, an employer-owned life insurance contract is a life insurance contract that is owned by a person engaged in a trade or business and under which that person is a beneficiary under the contract, and that covers the life of an insured who is an employee on the date the contract is issued. An applicable policyholder is a person who owns an employer-owned life insurance contract, or a related person as described in § 101(j)(3).

Section 101(j)(2) provides exceptions to the general rule of § 101(j)(1) in the case of certain employer-owned life insurance contracts with respect to which certain notice

and consent requirements are met. Those exceptions are based either on (i) the insured's status as an employee at any time during the 12-month period before the insured's death or as a director, a highly compensated employee or highly compensated individual at the time the contract is issued, or (ii) the extent to which death benefits are paid to (or used to purchase an equity interest in the applicable policyholder from) a family member, trust, or estate of the insured employee.

Section 6039I provides that every applicable policyholder that owns one or more employer-owned life insurance contracts issued after August 17, 2006, must file a return, at such time and in such manner as the Secretary prescribes, setting forth specific information for each year the contracts are owned. In order to satisfy this requirement, a taxpayer must file Form 8925. See § 1.6039I-1T of the regulations.

QUESTIONS AND ANSWERS

Definition of Employer-Owned Life Insurance Contract

Section 101(j)(3) provides that the term "employer-owned life insurance contract" means a life insurance contract that (1) is owned by a person engaged in a trade or business, and under which such person (or a related person) is directly or indirectly a beneficiary under the contract, and (2) covers the life of an insured who is an employee of the applicable policyholder on the date the contract is issued. The term "applicable policyholder" with respect to an employer-owned life insurance contract generally means the person who owns the contract. The term "applicable policyholder" also includes any person who bears a relationship specified in § 267(b) or § 707(b)(1) to the owner of the contract, or who is engaged in trades or businesses with the owner of the contract which are under common control within the meaning of § 52(a) or (b).

Q-1. Can a contract be an employer-owned life insurance contract if it is owned not by a person engaged in a trade or business, but by a related person who is not engaged in a trade or business?

A-1. No. A contract is an employer-owned life insurance contract only if it is owned by a person engaged in a trade or business and is otherwise described in § 101(j)(3). Thus, a contract that is owned by the owner of an entity engaged in a trade or business (such as for purposes of financing the purchase of an equity interest of another owner), or by a qualified plan or VEBA that is sponsored by an entity engaged in a trade or business, is not an employer-owned life insurance contract. A contract, however, that is owned by a grantor trust (such as a rabbi trust), assets of which are treated as assets of a grantor that is engaged in a trade or business, is an employer-owned life insurance contract if the contract is otherwise described in § 101(j)(3).

Q-2. Can a contract be an employer-owned life insurance contract if it is subject to a split dollar arrangement?

A-2. Yes. A contract that is subject to a split dollar arrangement is an employer-owned life insurance contract if the contract is owned by a person engaged in a trade or business and is otherwise described in § 101(j)(3). See § 1.61-22(c)(1) (defining the owner of a contract subject to a split dollar arrangement to be the person named as the policy owner of the contract). Under § 101(j)(2)(B), however, the general rule of § 101(j)(1) does not apply to the extent any amount received by reason of the death of the insured is paid to a family member of the insured, an individual who is a designated

beneficiary, a trust established for the benefit of a family member or designated beneficiary.

Q-3. Is a contract an employer-owned life insurance contract if it is owned by a partnership or sole proprietorship that is engaged in a trade or business; the partnership or sole proprietorship is directly or indirectly a beneficiary under the contract; and, the contract covers the life of an insured who is an employee with respect to the trade or business on the date the contract is issued?

A-3. Yes. If a life insurance contract is otherwise described in § 101(j)(3), ownership of the contract by a partnership or sole proprietorship does not prevent the contract from being treated as an employer-owned life insurance contract. A life insurance contract that is owned by a sole proprietor on his or her own life is not, however, an employer-owned life insurance contract.

Exceptions to the Application of § 101(j)(1)

Section 101(j)(2) provides several exceptions to the application of § 101(j)(1), provided the notice and consent requirements of § 101(j)(4) are met. Specifically, under § 101(j)(2)(A), § 101(j)(1) does not apply if the insured either was an employee at any time during the 12-month period before death, or was a director, highly compensated employee or highly compensated individual, as defined, at the time the contract was issued. Under § 101(j)(2)(B), § 101(j)(1) does not apply to any amount received by reason of the death of an insured to the extent the amount is paid to or used to purchase an equity (or capital or profits) interest from a family member of the insured,

an individual who is a designated beneficiary, a trust established for the benefit of a family member or designated beneficiary, or the estate of the insured.

Q-4. Under § 101(j)(2)(A) and (j)(4), when is a contract treated as "issued" for purposes of determining whether the notice and consent are timely, or whether the insured is a director, a highly compensated employee, or a highly compensated individual at the time the contract is issued?

A-4. Generally, the issue date of a contract is the date on the policy assigned by the insurance company, which is on or after the date the application was signed. Solely for purposes of § 101(j)(2)(A) and (j)(4), an employer-owned life insurance contract is treated as "issued" on the later of (1) the date of application for coverage, (2) the effective date of coverage, or (3) the formal issuance of the contract. Thus, if an employer-owned life insurance contract is effective for a limited period of time before formal issuance of the contract (such as to complete underwriting), the notice and consent requirements may be satisfied during the period between the effective date of coverage and formal issuance of the contract. In addition, an employer-owned life insurance contract may be treated as a new contract, and thus newly "issued," by reason of a material increase in death benefit or other material change in the contract. See A-14, this Notice.

Q-5. For purposes of § 101(j), is the term "employee" limited to common law employees?

A-5. No. Section 101(j)(5)(A) provides that the term "employee" includes an officer, director, and highly compensated employee (within the meaning of § 414(q)). A director is an independent contractor in his or her capacity as a director.

Section 414(q) contains special rules relating to certain former employees and self-employed individuals. For example, a former employee is treated as a highly compensated employee (within the meaning of § 414(q)) if the individual was a highly compensated employee when he separated from service, or was a highly compensated employee at any time after attaining age 55. In addition, the term "employee" for purposes of § 414(q) includes an individual who is a self-employed individual who is treated as an employee pursuant to § 401(c)(1).

Q-6. How soon after the death of an employee must an amount be used to purchase an equity (or capital or profits) interest in the applicable policyholder, in order to qualify for the exception set forth in § 101(j)(2)(B)(ii)?

A-6. In order to know whether an amount received as a death benefit under an employer-owned life insurance contract is eligible for exclusion from gross income under § 101(a), or is ineligible for exclusion under the general rule of § 101(j)(1), it is necessary to determine the availability of the exception for amounts used to purchase an equity (or capital or profits) interest in the applicable policyholder. Accordingly, an amount must be so paid or used by the due date, including extensions, of the tax return for the taxable year of the applicable policyholder in which the applicable policyholder is treated as receiving a death benefit under the contract.

Satisfaction of Notice and Consent Requirement

Even if an exception described in § 101(j)(2)(A) or (B) is otherwise satisfied, § 101(j)(2) requires that the notice and consent requirements of § 101(j)(4) be met in order for the general rule of § 101(j)(1) not to apply. The notice and consent requirements of § 101(j)(4) are met if, before the issuance of the policy, the employee

(1) 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; (2) provides written consent to being insured under the contract and that such coverage may continue after the insured terminates employment; and (3) is informed in writing that an applicable policyholder will be a beneficiary of any proceeds payable upon the death of the employee.

Q-7. Is notice and consent required of an owner-employee of a wholly-owned corporation?

A-7. Yes. Section 101(j)(4) provides no exception that would excuse a wholly-owned corporation and its employee-owner from the notice and consent requirements that otherwise apply, nor can actual knowledge alone substitute for the statutory requirement that notice and consent be "written." Moreover, the requirement that notice and consent be written avoids factual controversies that otherwise could result where, for example, the sole owner of a corporation delegates financial matters to an employee.

Q-8. Is notice and consent required with regard to an existing life insurance contract that an employee irrevocably transfers to an employer?

A-8. No. The actual transfer of an existing life insurance contract by an employee to an employer is sufficient to satisfy the requirements that the employee be notified in writing of the intention to insure and the maximum face amount of insurance, that written consent be secured, and that the employee be notified that the employer will be a beneficiary upon his or her death. In the event the employer subsequently

increases the face amount of the contract, however, written notice and consent must be secured to establish the requisite notice to the employee and consent to the new face amount.

Q-9. How soon after an employee provides written consent must a contract be issued in order for the consent to be valid for purposes of § 101(j)(4) with regard to the contract?

A-9. In order for the employee's consent to satisfy the requirements of §101(j)(4) with regard to a contract, the contract must be issued before the earlier of (1) the expiration of the one-year period beginning on the date the consent was executed, or (2) termination of the employee's employment with respect to the trade or business of the applicable policyholder. It is not necessary to provide further notice or renew an employee's consent with regard to an existing contract unless, for example, the total face amount of the employer owned life insurance contracts with regard to the employee exceeds the amount of which the employee was notified and to which the employee consented as described in § 101(j)(4).

Q-10. May a single consent apply to more than one employer-owned life insurance contract?

A-10. Yes. As long as the notice and consent requirements of § 101(j)(4) are otherwise met, the fact that more than one contract is acquired with regard to an employee who executed a single consent does not prevent an exception under § 101(j)(2) from applying. Thus, for example, if an employee is appropriately notified that an applicable policyholder intends to insure the employee's life for a maximum

\$1 million face amount and the employee consents in writing, the applicable policyholder may purchase two employer-owned life insurance contracts, each with a face amount of \$500,000, and satisfy the requirements of § 101(j)(4).

Q-11. May the notice and consent requirements of § 101(j)(4) be satisfied electronically?

A-11. Yes. Although § 101(j)(4)(A) and (C) require that notification be "in writing," and § 101(j)(4)(B) requires that consent be "written," this requirement may be satisfied electronically so long as the system for electronic notification and consent includes the elements set forth in § 101(j)(4) (notification of intention to insure and maximum face amount, consent to insurance and continuation after termination of employment, and notification that an applicable policyholder will be a beneficiary of any proceeds payable upon the employee's death). In addition, the system must (1) ensure that the information received by the employee is the same as the information sent by the employer; (2) make it reasonably certain that the person accessing the system is the employee for whom notice and consent is required; (3) include a process for electronic signature or other means of formally recording the employee's consent to being insured; and (4) permit the production of a hardcopy of the electronic notice and consent upon request by the Internal Revenue Service (Service) and a statement that, to the best of the employer's knowledge, the required notice was provided to the employee and the employee consented to being insured. Compare § 31.3402(f)(5)-1(c)(2) (providing administrative requirements in the case of electronically filed Forms W-4).

Q-12. Are the notice and consent requirements of § 101(j)(4) met by advising an employee that the face amount of life insurance may be "the maximum face amount for which the employee could be insured" at the time the contract is issued?

A-12. No. The requirement of § 101(j)(4)(A) that the employee be notified in writing of the maximum face amount of life insurance requires the disclosure of a face amount of life insurance, either in dollars or as a multiple of salary, that the applicable policyholder reasonably expects to purchase with regard to the employee during the course of the employee's tenure. Additional notice and consent are required if the aggregate face amount of the employer-owned life insurance contracts with regard to an employee exceeds the amount of which the employee was given notice and to which the employee consented.

Q-13. How can an inadvertent failure to satisfy the notice and consent requirements of § 101(j)(4) be corrected?

A-13. Section 101(j) does not contain a provision for correcting an inadvertent failure to satisfy the notice and consent requirements of § 101(j)(4). The Service will not, however, challenge the applicability of an exception under § 101(j)(2) based on an inadvertent failure to satisfy the notice and consent requirements if the following conditions are met: (1) 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; (2) the failure to satisfy the requirements was inadvertent; and (3) 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. Because § 101(j)(4)(B) requires that the employee's consent be written, failure to obtain such consent cannot be corrected after the insured employee has died.

Transition Rule and Section 1035 Exchanges

Pursuant to § 863(d) of the PPA, § 101(j) applies to life insurance contracts issued after August 17, 2006, except for a contract issued after that date pursuant to a § 1035 exchange for a contract issued on or before that date. For this purpose, any material increase in the death benefit of other material change causes the contract to be treated as a new contract and thus subject to § 101(j). (In the case of a master contract within the meaning of § 264(f)(4)(E), however, the addition of covered lives is treated as a new contract only with respect to the additional covered lives.)

Q-14. If there is no actual exchange of an existing employer-owned life insurance contract for a new contract, what changes to the contract are nevertheless sufficiently material to cause the contract to be treated as a new contract and thus subject to § 101(j)?

A-14. The following changes are not treated as material changes for purposes of determining whether an existing contract is treated as a new contract for purposes of § 101(j): (1) increases in death benefit that occur as a result of either the operation of § 7702 or the terms of the existing contract (provided the insurer's consent to the increase is not required); (2) administrative changes; (3) changes from general account to separate account or from separate account to general account; or (4) changes as a result of the exercise of an option or right granted under the contract as originally issued. Thus, for example, a death benefit increase does not cause a contract to be

treated as a new contract if the increase is necessary to keep the contract in compliance with § 7702, or if the increase results from the application of policyholder dividends to purchase paid-up additions, or if the increase is the result of market performance or contract design with regard to a variable contract. Notice and consent are required if a contract is treated as a new contract by reason of a material increase in death benefit or other material change, unless a valid consent remains in effect with regard to the insured.

Q-15. Under what circumstances does § 101(j) apply to a contract that is received after August 17, 2006, in an exchange for an employer-owned life insurance contract issued on or before that date?

A-15. Section 863(d) of the PPA provides that § 101(j) generally does not apply to a contract issued after August 17, 2006 in an exchange described in § 1035 for a contract issued on or before that date. Section 863(d) also provides that, for purposes of determining when a contract is issued, a material increase in the death benefit or other material change generally causes the contract to be treated as a new contract. A § 1035 exchange that results in a material increase in death benefit or other material change (other than a change in issuer) is treated as the issuance of a new contract after August 17, 2006 for purposes of determining whether § 101(j) applies to the contract. See A-14, this Notice.

Q-16. Under what circumstances is notice and consent required with regard to a contract received in a § 1035 exchange for an employer-owned life insurance contract issued after August 17, 2006, for which the notice and consent requirements were previously satisfied?

A-16. No further notice and consent are required if either (1) the existing consent remains valid (see A-9, this Notice), or (2) the exchange does not result in a material change in the death benefit or other material change in the contract. The same standards apply to determine whether a change is "material" for this purpose as apply to determine whether an exchange results in a material increase in death benefit of other material change under the transition rule for purposes of determining whether § 101(j) applies to a contract. See A-14, this Notice.

Information Reporting under Section 6039I and Form 8925

Section 6039I and Form 8925 require that every applicable policyholder owning 1 or more employer-owned life insurance contracts issued after August 17, 2006, provide the following information showing for each year the contracts are owned: (1) the number of employees of the applicable policyholder at the end of the year; (2) the number of such employees insured under such contracts; (3) the total amount of insurance in force at the end of the year under such contracts; (4) the name, address, and identifying number of the applicable policyholder and the type of business in which the policyholder is engaged; and (5) that the applicable policyholder has a valid consent for each insured employee (or, all such consents are not obtained, the number of employees for whom such consent was not obtained).

Q-17. Are there circumstances under which more than one taxpayer may be required to file Form 8925 by reason of the same employer-owned life insurance contract?

A-17. Section 6039I requires that a return be filed by "every applicable policyholder owning 1 or more employer-owned life insurance contracts issued after the

date of enactment." Section 6039I(c) provides that any term used in § 6039I that is also used in § 101(j) has the same meaning given the term by § 101(j). Under § 101(j)(3)(B)(i), the term "applicable policyholder" is generally the owner of the employer-owned life insurance contract. Although § 101(j)(3)(B)(ii) also includes certain related persons in the definition of "applicable policyholder," those related persons are not the applicable policyholders who own the contracts. Only the applicable policyholder "owning 1 or more employer-owned life insurance contracts" is required to file Form 8925.

EFFECTIVE DATE

This Notice is effective June 15, 2009. The Service will not challenge a taxpayer who made a good faith effort to comply with § 101(j) based on a reasonable interpretation of that provision before that date.

DRAFTING INFORMATION

The principal author of this Notice is Linda K. Boyd of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this Notice, contact Linda K. Boyd at (202) 622-3970 (not a toll-free call).