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Advanced Markets

Taxation of employer owned life insurance

Taxation of death benefits to the business

When a business receives the death benefit from an employer-owned life insurance policy, the IRS allows them to exclude from income the amount of premiums and amounts paid into the policy.[4] The remaining amount of the death benefit received is reported as income to the business. Exceptions to this IRS inclusion rule could allow the entire death benefit proceeds to be free of income tax to the business, once the business satisfies the notice and consent requirements, and any one of the following:

1. Exception for a recent employee: The insured was an employee of the employer at any time during the 12-month period before the insured's death.[5]

2. Exception for a director or highly compensated employee or individual at the time the policy was issued. This would include:[6]

- A director
- A 5%-or-greater owner of the business at any time during the current year or the preceding year
- A highly compensated employee or highly compensated individual with compensation of at least $130,000 for 2021 (adjusted annually for cost-of-living)
- One of the five highest-paid officers
- Among the highest-paid 35% of all employees

3. Exception for death proceeds paid to heirs: The death proceeds are paid to:[7]

- A member of the insured's family, which includes brothers and sisters (also half-brothers and half-sisters), spouse, ancestors, and lineal descendants
- Any individual who is the designated beneficiary of the insured under the contract (other than the employer)
- A trust established for any family member or designated beneficiary, as just described
- The estate of the insured

4. Exception for death benefit proceeds being used to purchase an equity interest in the business (employer) by any family member, beneficiary, trust, or estate.[8]

[4] IRC §101(j)(1)
[5] IRC §101(j)(2)(A)(i)
[6] IRC §101(j)(2)(A)(ii)
[7] IRC §101(j)(2)(B)(i)
[8] IRC §101(j)(2)(B)(ii)

Annual filing requirements

Employers that own life insurance on their employees also must comply with the ongoing requirement outlined in IRC § 6039I, which requires an annual report of EOLI contracts. Reporting is accomplished by attaching IRS Form 8925 to the employer's income tax return for the year.

The employer must report the following to the IRS annually:

- The total number of employees under the employer at the end of the tax year
- The number of those employees insured under employer-owned life insurance contracts at the end of the tax year for policies issued after August 17, 2006
- The total amount of insurance in force at the end of the tax year under those contracts
- The name, address, and taxpayer identification number of the employer, and the type of business in which the employer is engaged
- Verification that the employer has a valid consent for each insured employee, or, if all required consents are not obtained, the number of insured employees for whom consent was not obtained

Employers are required to keep records that show the requirements of both IRC § 101(j) and 6039I are met for all applicable tax years by filing IRS Form 8925, "Report of Employer-Owned Life Insurance Contracts."

Notice and consent

There are three components to the notice and consent requirement that must be met before the policy is issued:

1. Notify the employee in writing that the employer intends to insure the employee's life. The notice must state the maximum face amount for which the employee could be insured and must be either in dollars or as a multiple of salary.

2. Obtain the employee's written consent to being insured under the policy.

3. Inform the employee in writing that the employer will be directly or indirectly a beneficiary of any proceeds payable on the employee's death.

An inadvertent failure to satisfy the notice and consent requirements may be corrected under the following circumstances:[9]

1. The applicable policyholder (business/employer) made a good faith effort to satisfy those requirements.

2. The failure was inadvertent.

3. The failure was discovered and corrected no later than the due date of the tax return for the taxable year of the applicable policyholder (business/employer) in which the policy was issued.

[9] IRS Notice 2009-48, Q-13 & A-13

Sample notice of consent

Employer intent to insure employee's life

______________________________________ ("Employee") is being notified by

______________________________________ ("Employer") under Internal Revenue Code § 101 (j) that:

A. Employer intends to apply for insurance on Employee's life;

B. The maximum face amount at the time the policy is issued on the life of the Employee shall

not exceed $______________________; and

C. Employer shall be a direct or indirect beneficiary of life insurance proceeds payable upon death of Employee.

Employee consent to being insured

Employee acknowledges receipt of this notice and agrees to:

A. Consent to being insured by Employer;

B. Consent to the policy being continued following any termination of employment with Employer; and

C. Consent to employer being a direct or indirect beneficiary of any life insurance proceeds payable.

Employee ______________________________

Date ______________________________

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