



# protecting business clients from “eoli shortfalls”

Presented By:

AXA Equitable  
Advanced Marketing



AXA Equitable Life Insurance Company  
New York, NY 10104 (212) 314-4600

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redefining / standards



# Think Again...

**Are you aware that life insurance death benefits paid to an employer ARE subject to income tax?**

## **UNLESS**

1) Certain requirements are met

AND

2) Certain notice and consent procedures are complied with

# Manage Expectations – The Facts

- Under IRC 101(a)(1), the general rule is that the death benefit of a life insurance contract is not included in gross income.

*Little known fact:* The death benefit of an employer-owned life insurance (“EOLI”) contract is generally taxable.

*Less known fact:* Federal income taxation can be avoided only when the Employer complies with certain IRS rules.

# EOLI versus COLI

- Is Employer-Owned Life Insurance the same as Corporate-Owned Life Insurance? NO!
- Employer business forms include LLCs, Partnerships, Sole Proprietorships, C-Corps, and S-Corps
- IRC 101(j) applies to all persons “engaged in a trade or business”

EOLI  $\neq$  COLI

# On the Agenda

## **MANAGE** Expectations

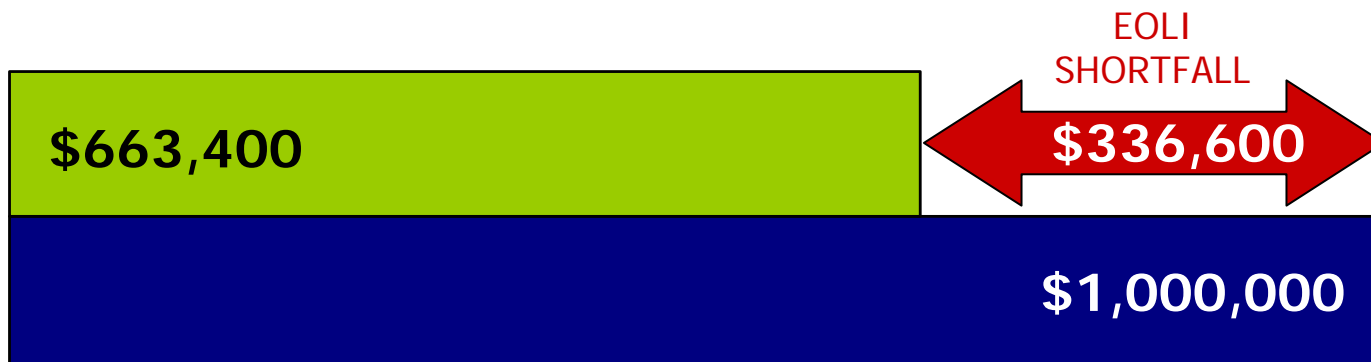
**PROTECT** from “EOLI Shortfalls”

**DEVELOP** Relationship Opportunities

# The "EOLI Shortfall"

DID THE EMPLOYER COMPLY WITH EOLI RULES?

■ YES ■ NO



# Case Study: Crafty Cakes Bakery Buy-Sell

Crafty Cakes Bakery, Inc., co-owned by Charles and Mary

- Business Valuation: \$2,000,000
- Buy-Sell Stock Redemption
- \$1,000,000 death benefit policy purchased on the life of each owner
- Annual Premium on each policy: \$10,000
- Tax Rate: 34%



# Case Study: Charles' Expectations

- Continuation of successful business growth
- Properly established and funded buy-sell agreement
- \$10,000 annual premium payments
- Income tax-free \$1,000,000 death benefit



# Case Study: What Really Happens!

- Mary dies, and Charles is the surviving owner.
- 34% corporate income tax on the death benefit
- EOLI shortfall of \$336,600 - amount the employer needs to pay the IRS in income taxes on the death benefit **due to non-compliance** with the EOLI rules.
- Only \$663,400 is ultimately available for the buyout.
- Potential co-owner with Bobby, Mary's son
- Business value decline due to:
  - Loss of Mary
  - Need to liquidate assets to satisfy buy-sell obligation

# EOLI Shortfall Calculations

- For illustrative purposes in this case study, we assume premiums paid is \$10,000.
- Death benefit subject to income tax – premiums paid = amount subject to income tax

$$\mathbf{\$1,000,000 - \$10,000 = \$990,000}$$

- Income taxes payable on death benefit X marginal corporate income tax rate

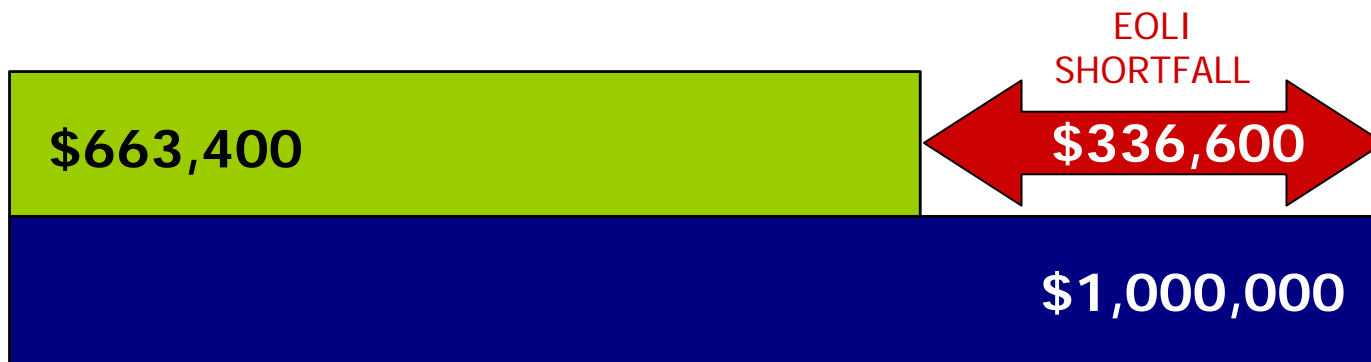
$$\mathbf{\$990,000 \times 34\% = \$336,600}$$



# The "EOLI Shortfall"

DID THE EMPLOYER COMPLY WITH EOLI RULES?

■ YES ■ NO



# Manage Expectations –Application

	Yes, it probably is EOLI <sup>1</sup>	No, it probably isn't EOLI	Pending Further Guidance, Assume it's EOLI for now <sup>1</sup>
<b>Sole Proprietorships</b>			
On Proprietor		✓	
On an Employee	✓		
<b>Split Dollar Arrangements</b>			
Endorsement (Employer Owned)	✓		
Equity Collateral Assignment (Employee Owned)		✓	
Non-Equity, Collateral Assignment, Economic Benefit Regime Split Dollar			✓
<b>Section 162 Bonus Plan</b>		✓	

<sup>1</sup> The following forms must be included with life insurance applications in the situations checked under this column: in Washington State, the Notice and Consent Form (# 140385); in all States but Washington State, the Acknowledgement and Disclosure Form (#141825).



# Application

	Yes, it probably is EOLI <sup>1</sup>	No, it probably isn't EOLI	Pending Further Guidance, Assume it's EOLI for now <sup>1</sup>
<b>Buy-Sell Arrangements</b>			
Redemption/Entity Purchase	✓		
Cross-Purchase all business forms except partnership		✓	
Partnership Cross-Purchase <sup>2</sup>			✓
<b>Qualified Plan Trust</b>		✓	
<b>VEBA</b>		✓	

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<sup>2</sup> In an informal discussion with an IRS representative it was confirmed that this issue had not been considered.



# Application

	Yes, it probably is EOLI <sup>1</sup>	No, it probably isn't EOLI	Pending Further Guidance, Assume it's EOLI for now <sup>1</sup>
<b>Charitable Life Insurance<sup>2</sup></b>			
On an Employee			✓
On a Non-Employee Donor		✓	
<b>Non-Qualified Deferred Compensation (policy used as informal funding assets)</b>	✓		
<b>Death Benefit Only Plans</b>	✓		
<b>Rabbi Trust</b>	✓		
<b>Key Person</b>	✓		

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# The Parties

Party	Expectation	Penalty for Failure
Client/Employer	Life Insurance DB is income tax free	Income taxes
Producer	Planning has addressed client need	Reputation Possible liability
IRS	Compliance	Income taxes

# On The Agenda...

**MANAGE** Expectations

**PROTECT** from “EOLI Shortfalls”

**DEVELOP** Relationship Opportunities

# Protect from “EOLI Shortfalls”

## Initial IRS Requirements

Effective for cases issued after August 17, 2006 or subject to a material change after that date.

### **PART 1**

- Meets An Exception

AND

### **PART 2**

- Signed Employee Notice and Consent

# Part 1: Exceptions

1. Amounts paid to beneficiaries
2. At time contract was issued, the insured was
  - A Director
  - Highly compensated
    - 5% owner
    - Comp at a certain level (\$110,000 in 2009)
    - Among the highest paid 35% of employees
3. Recent Employees - Insured was an Employee within 12 months of the date of death



# Part 1: Initial IRS Requirements: Employee Exceptions (cont.)

## Timeline for each exception

**Amounts Paid to Heirs** (Paid within the tax year received)



**Directors or Highly Compensated** (At the time of issue)



**Recent Employees** (Had been an EE within 12 months of death)



## Part 2: Employee Notice and Consent

- Prior to issue of the life insurance contract the Employee must be notified in writing AND Employee must consent in writing to the following:
  - Employer intends to insure the Employee
  - Maximum amount of applied for coverage
  - Employer will be the owner and beneficiary of the policy
  - Employer will have the right to continue the contract after employment is terminated



# Can an Employer Make a Correction?

- IRS Notice 2009-48
  - Notice and Consent can NOT be assumed from facts
  - “Inadvertent” failure to comply”
    - Good faith effort was made
    - Correction made by tax return due date
- Other possibilities
  - Transfer to EE and then back again
  - Surrender policies & buy new ones
    - *not* §1035 Exchange

# Protect from “EOLI Shortfalls” Summary

## Points to recall

1. Initial requirements:
  - a. Meet Exception AND
  - b. Written Notice and Consent
2. No absolute means to correct
3. Policies Issued Up to and including August 17, 2006 - material changes?

# Annual IRS Requirements:

Effective for tax years ending after November 13, 2007

Employer must annually file with the IRS a summary of all EOLI policies

- Number of total employees vs. insured employees with policies issued after August 17, 2006
- Total in force insurance on Employees
- Policyholder details, including type of business
- Represent policyholder has valid consent for each insured employee, otherwise, note the names of those for whom consent was not obtained

# Annual IRS Requirements:

Form **8925**  
 (January 2006)  
 Department of the Treasury  
 Internal Revenue Service (99)

## Report of Employer-Owned Life Insurance Contracts

▶ Attach to the policyholder's tax return—See instructions.

OMB No. 1545-2089

Attachment  
 Sequence No. **160**

Name(s) shown on return	Identifying number
Name of policyholder, if different from above	Identifying number, if different from above
Type of business	
<b>1</b> Enter the number of employees the policyholder had at the end of the tax year . . . .	<b>1</b>
<b>2</b> Enter the number of employees included on line 1 who were insured at the end of the tax year under the policyholder's employer-owned life insurance contract(s) issued after August 17, 2006. See <i>Section 1035 exchanges</i> below for an exception . . . . .	<b>2</b>
<b>3</b> Enter the total amount of employer-owned life insurance in force at the end of the tax year for employees who were insured under the contract(s) specified on line 2 . . . . .	<b>3</b>
<b>4a</b> Does the policyholder have a valid consent (see instructions) for each employee included on line 2? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No	
<b>b</b> If "No," enter the number of employees included on line 2 for whom the policyholder does not have a valid consent . . . . .	<b>4b</b>

### General Instructions

Section references are to the Internal

**Related person.** A related person is considered a policyholder if that person is (a) related to the policyholder

insurance contracts issued after August 17, 2006, must file Form 8925 for each tax year the contract(s) is



# Annual IRS Requirements:

- Demonstrates that Congress and the IRS have their eyes on EOLI
- Special Form, IRS 8925
- Failure to file triggers and administrative penalty
- Correction may be to re-file annual tax return



# State Specific Considerations

- California
- Massachusetts
- Washington
- New York



# On The Agenda...

**MANAGE** Expectations

**PROTECT** from “EOLI Shortfalls”

**DEVELOP** Relationship Opportunities

# Develop Relationship Opportunities

- Become the expert
  - Establish credibility with Employers and other Advisors
  - Help clients make informed decisions
- Reach out to Centers of Influence
  - Stand apart from other Advisors



# Best Practices

- Identify EOLI cases upfront and advise employers to secure notice and consent forms.
- Provide employers with a checklist for EOLI compliance.
- Raise the issue during planning.
- Send letters to existing, business clients, prospective business clients, and centers of influence and advise them of these significant changes.



# Best Practices: Checklist

✓		Action Item	Responsible Party	Date Completed
	1)	Verify that, at the time of policy issue, 1) the employee/insured is a Director or Highly Compensated Employee OR 2) Amounts under the contract are to be paid to heirs of the employee.		
	2)	Notify the employee in writing of the employer/policyholder's intent to insure the employee's life and the maximum face amount for which the employee could be insured at the time the contract is issued.		
	3)	Obtain the employee's written consent to being insured under the contract, to such coverage continuing after termination of employment, and confirmation that the employee has been informed in writing that the employer/policyholder will be the beneficiary of any proceeds payable upon the death of the employee.		
	4)	Review employer/policyholder's existing policies for any material changes, including an increase in face amount.		
	5)	Prepare for the filing of an annual reporting form (IRS Form 8925) with your tax return.		



# Develop Relationship Opportunities

- Failure can result in income taxation of life insurance death benefit (don't let the failure to comply be yours)
- Portion of the death benefit payable to the employer, less premiums paid, subject to income tax. (If there is a tax, make certain the beneficiaries are not knocking on your door to cover the short fall.)
- Protect your client up front rather than try to correct later.



# The AXA Equitable Difference

- Materials to notify and educate clients/employers
- A procedure in place
  - AXA Equitable stands apart with its process in place that Employers can implement.
  - Great value in providing guidelines for Employers to comply with IRS rules
  - Consequences of non-compliance are significant.



# AXA Equitable (“AXA”) Procedures

- For cases identified as Employer-owned, AXA generally requires the broker to provide the Employer with the appropriate (NY and WA have state specific) EOLI summary entitled *“Important Information Regarding Employer-Owned Life Insurance Policies”*
- At the same time, the Employer must sign and submit a statement entitled *“Acknowledgement and Disclosure Form For Employer-Owned Life Insurance Policies”* certifying either 1) they received this information and understand that they are generally responsible for compliance OR 2) they do not believe 101(j) to apply.
  - NOT Required for WA.
- We also provide the employer with the appropriate (NY and WA have state specific) “Notice and Consent” form to be used for IRS compliance purposes in obtaining the Employee’s consent.

# "Acknowledgement and Disclosure Form For Employer-Owned Life Insurance Policies"

1 Version

**ACKNOWLEDGEMENT AND DISCLOSURE FOR  
EMPLOYER-OWNED LIFE INSURANCE POLICIES**

In connection with the purchase of life insurance policies from AXA Equitable Life Insurance Company and/or one of its affiliates on the following insured(s) *(attach extra pages if necessary)*:

<i>Name of Insured</i>	<i>Policy No. (if existing policy)</i>
_____	_____
_____	_____
_____	_____

On behalf of the Employer, the undersigned authorized representative acknowledges that the employer named below ("Employer") has received the document entitled "**Important Information Regarding Employer-Owned Life Insurance Policies**" and it is understood that the Employer is solely responsible for ensuring that it complies with all legal requirements of IRC 101(j) related to life insurance it purchases on its employees. In addition, the representative confirms either

The employer has provided notice to the employee and obtained the employee's signed consent to purchase life insurance on their life; or,

The employer has determined, whether individually or with the advice of their counsel, that the provisions of IRC 101(j) do not apply to this situation and does not intend to obtain the employee's signed consent.

*(Initial the box next to the option that applies)*

\_\_\_\_\_  
*Employer Name*

\_\_\_\_\_  
*Signature of Authorized Business Representative*

\_\_\_\_\_  
*Name and Title of Authorized Business Representative  
(Please Print)*

\_\_\_\_\_  
*Date*

Option if Employer believes IRC 101(j) does not apply.

"Business Representative"

Producers: This form must be filed with the life insurance application for Employer Owned Life Insurance in all states but Washington State.  
AAM 7-001 (10/08) Catalog # 141825

# AXA Forms and Materials

- “Important Information Regarding EOLI”
  - #137310 (Non-New York and Non-Washington Employers)
  - #137309 (New York Employers)
  - #140425 (Washington Employers)
- “Employer Acknowledgement & Disclosure For EOLI”
  - #141825 (For All States Except Washington)
- “Notice and Consent Form For EOLI”
  - #137311 (Non-New York and Non-Washington Employers)
  - #137132 (New York Employers)
  - #140385 (Washington Employers)
- Letter for Brokers to contact Employer Clients #138176
- Planning Perspective #138174
- Field Bulletin # AD 08-129
- Marketing Materials

# The AXA Equitable Difference

## AXA Equitable's EOLI toolbox

- Model letter for producer use with existing business clients, prospective business clients, and centers of influence.
- A comprehensive approach with a set procedure and forms. Field Bulletin AD 08-129.
- Producer and Client Marketing Materials



# Important Information

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1290 Avenue of the Americas, New York, NY 10104, (212) 554-1234

