Another Method to Provide Notice and Consent: Private Letter Ruling 2012-17-017 (Jan. 20, 2012)

Summary

The IRS approves an alternate method to satisfy the notice and consent rules for employer-owned insurance.

Related Information

New Guidance on Employer-Owned Insurance; Time to Report Employer-Owned Life Insurance Policies-Here's How; Pension Protection Act of 2006: Key Provisions of the Act.

Background

Section 101(j) generally provides that death benefits under employer-owned life insurance policies issued or materially changed after August 17, 2006 are income taxable if they insure employees, officers, or directors. Luckily, there is an exception to this rule if, before the policy is issued:

1. The employer notifies the employee in writing that it intends to purchase life insurance on the employee's life payable to the employer, indicating the maximum face amount of such coverage; and

2. The employee consents in writing to the coverage.[1]

To satisfy these written notice and consent requirements before a policy is issued, employers often use a form provided by the insurance company.

In 2009 the I.R.S. provided additional guidance on 101(j) through Notice 2009-48,[2] including opening the door for waiving inadvertent failures to comply with the notice and consent requirements if the employer made a good faith effort to comply, including adopting formal notice and consent procedures.[3]

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1 If the notice and consent requirements are met, the death benefit remains income tax-free without any time limit if the insured was a highly compensated employee or director when the policy was issued. If the employee does not fit that category when the policy was issued, then the death benefit remains income tax-free only if the insured dies while employed or within a year after leaving employment. § 101(j)(2). Also see Advanced Planning Letter No. 181: Detailed Analysis of the Pension Protection Act (September 2006).

2 Notice 2009-48, 2009-24 I.R.B. 1085.

3 See New Guidance on Employer-Owned Insurance, *Advanced Planning Bulletin* (July 2009).

Facts

A closely held corporation enters into a buy-sell agreement with its shareholders (who are also employees), and purchases life insurance on their lives. The corporation does not use forms or any other specific writing to provide notice and obtain consent of the insureds prior to the issuance of the policies. However, the shareholder-employees know about the policies because they (i) sign the buy-sell agreement and (ii) sign the insurance applications.

Ruling

The notice and consent requirements of 101(j) are satisfied by the shareholder-employees signing the buy-sell agreement and life insurance applications.

Reasoning

The notice and consent requirements of section 101(j) include several elements:

1. The insured employee is notified in writing that the employer intends to purchase life insurance on the employee's life;

2. The notice indicates the maximum face amount on the policy;

3. The employee consents in writing;

4. The consent indicates that the coverage may continue after termination of employment; and

5. The employee is notified that the employer will be a beneficiary of the death benefit.

In this case each of these elements is satisfied through the buy-sell agreement and the life insurance applications, which together provide the required notice and include the required signed consent.

Observation

Northwestern Mutual provides notice and consent forms as part of the application process when companies apply for life insurance.[4] Such forms are still the best way to satisfy the notice and consent requirements of § 101(j). However, if these or similar forms are not used for some reason, this ruling is very good news, as it suggests an alternative way for satisfying the requirements (although some might feel safe only if they get their own private letter ruling).

If the notice and consent requirements are not met prior to policy issuance through either method, options to avoid taxable death benefit include starting over with a new policy or materially changing the policy, but doing so with new notice and consent.

[4] See Northwestern Mutual Forms 90-2310 and 90-2311.

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