

Financial Services - Insurance Tax Bulletin

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*COLI policies purchased by a
closely held corporation satisfies
section 101(j)(4)*

In PLR 201217017, the IRS ruled that corporate-owned life insurance policies purchased by a closely held corporation on the lives of its shareholders sufficiently satisfied the notice and consent requirements of §101(j)(4).

Taxpayer is a closely-held corporation whose shareholders are also its employees. Taxpayer executed an Agreement with each shareholder providing that Taxpayer will obtain life insurance on the life of each shareholder, and that Taxpayer will be the owner and beneficiary of the life insurance. Taxpayer subsequently purchased Number A life insurance contracts. The process of purchasing these contracts required the shareholder to complete an application. The application indicated that Taxpayer was to be the owner and beneficiary, and the amount of coverage being obtained. Prior to purchasing these life insurance contracts, Taxpayer did not obtain separate documentation from each affected shareholder. However, Taxpayer obtained separate documentation after purchasing these life insurance contracts.

Under § 101(j), in the case of an employer-owned life insurance contract, the amount of death benefits excluded from gross income 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. §101(j)(2) provides exceptions to this general rule in the case of certain employer-owned life insurance contracts with respect to which certain notice and consent requirements are met. These exceptions apply only if the notice and consent requirements of § 101(j)(4) are satisfied.

In general, under § 101(j)(4), before the issuance of the contracts, each shareholder must have:

- a) Received notice in writing that Taxpayer intended to insure the Shareholder's life;
- b) Received notice in writing of the maximum face amount for which the shareholder could be insured at the time the contract was issued, either in dollars or as a multiple of salary;
- c) Provided written consent to being insured under the contract;
- d) Provided written consent that such coverage may continue after the Shareholder terminates employment; and,
- e) Received notice in writing that Taxpayer will be a beneficiary of any proceeds payable upon the death of the Shareholder.

However, Notice 2009-48 indicates that the IRS will not challenge an exception under § 101(j)(2) based on an inadvertent failure to satisfy the notice and consent requirements, where the policyholder made a good faith effort to comply, the failure to satisfy was inadvertent, and the failure to obtain notice and consent was discovered and corrected no later than the due date of the applicable tax return.

Considering all of Taxpayer's documentation, the IRS determined that all of the requirements of § 101(j)(4) were met because, through the agreement and the application, each shareholder was notified in writing that Taxpayer intended to insure the Shareholder's life. In addition, through the application, each shareholder was notified in writing of the maximum face amount for which the Shareholder could be insured at the time the contract was issued, in dollars. Also, by signing both the agreement and the application, each shareholder consented to being insured under the contract, and consented that such coverage may continue after the shareholder terminates employment. Finally, the IRS found that through the agreement and the application, each shareholder was informed in writing that Taxpayer will be a beneficiary of any proceeds payable upon the death of the shareholder.

PwC Observation

Taxpayers should consider all the facts and circumstances of this ruling. The IRS said that while the taxpayer did not obtain a separate, form-style document from each shareholder, considering all of the documentation as a whole the requirements of § 101(j)(4) were met.

For further information, please feel free to contact Anthony DiGilio at (703) 918-4812 or contact your local insurance tax professional.

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