Beware of the Tax Traps of Employer-Owned Life Insurance Contracts



Image by NY Photographic

In closely held businesses, it is common practice to provide for the succession of the business upon the death of an owner. More often than not, such succession planning involves the use of life insurance on the life of an owner, whether to fund a redemption of the deceased-owner's interest in the company, to make up for lost revenues resulting from the owner's death, or to achieve other economic results, writes **Mitchell Goldberg** of **Berger & Singerman**.

"Where the company is the owner and beneficiary of the life insurance policy, the company and its principals (i.e. shareholders, members, partners) need to be mindful that certain formalities under the Internal Revenue Code (the "Code") must be followed to ensure that the death benefit proceeds are completely tax-free under the Code," **he explains**.

"The Code generally excludes from gross income amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured. However, in the case of an employer-owned life insurance contract (i.e. a life insurance contract owned by a "person" engaged in a trade or business and under which such person is a beneficiary and that insures the life of an employee of such person on the date the contract is issued), unless certain requirements are satisfied, the amount excluded under the Code is limited to the aggregate amount of

premiums and other related amounts paid by the employer.”

Read the article.