



COLI Best Practices Overview

The COLI Best Practices Provision, within The Pension Protection Act of 2006, was signed into law on August 17, 2006. This provision was designed to codify industry “best practices” regarding employer-owned life insurance and amend the Internal Revenue Code of 1986 to exclude from gross income the proceeds from certain company-owned life insurance. The Act amends Section 101(j) of the Internal Revenue Code by adding subsection (j), “treatment of Certain Employer Owned Life Insurance Contracts,” and adds Section 60391, “Returns and Records With Respect to Employer-Owned Life Insurance Contracts.”

Under Section 101(j), the employer owned death benefit proceeds will be considered eligible for exclusion from the employer’s income provided all of the following Notice and Consent Requirements and one of the Specified Exceptions are met prior to the issuance of the insurance contract.

Notice and Consent Requirements

The Employee must:

- a) Be notified in writing that the employer intends to insure the employee’s life and the maximum face amount for which the employee could be insured at the time the contract was issued.
- b) Provide written consent to be insured under the contract during and after active employment
- c) Be informed in writing that the employer will be the beneficiary of any death benefits.

Specified Exceptions

- a) **Recent Employees:** The insured employee was employed by the employer during the 12-month period preceding death.
- b) **Directors and Highly Compensated Employees:** At time of contract issue, the insured employee; was a director, *or* a 5% or greater owner of the business at any time during the preceding year, *or* received compensation equal to or in excess of the annual published IRS limit, adjusted in the future for inflation, in the preceding year, *or* was one of the five highest-paid officers, *or* was among the highest-paid 35% of all employees.
- c) **Death Benefits Paid to Insured’s Heirs:** Death benefits to the extent paid to a member of the insured’s immediate family, to the insured’s designated beneficiary under the policy, to a trust for the benefit of a family member or designated beneficiary or to the estate of the insured; or used to purchase an interest in the employer from any of the preceding persons.

If the above are not satisfied to the Internal Revenue Service’s satisfaction, the eligible amount of death benefit an employer is allowed to exclude from gross income is equal to the sum of the premiums and other amounts paid for the contract.

ADDITIONAL IRS GUIDANCE: IRS NOTICE 2009-48 (May 22, 2009)

On May 22, 2009, the IRS issued Notice 2009-48 (the Notice), which addresses several questions surrounding the treatment of employer-owned life insurance contracts under IRC Section 101(j) and Section 6039I.

I. Definition of Employer-Owned Life Insurance Contract

The Notice states that a policy is “employer-owned” for Section 101(j) purposes only if it is owned by a person engaged in a trade or business; a policy that is owned by a business owner or a qualified plan (or VEBA) of an employer is *not* an employer-owned contract for Section 101(j) purposes. An employer-owned policy subject to a split-dollar arrangement is subject to the provisions of Section 101(j), as is a life insurance policy owned by a partnership or sole proprietorship.

Exceptions to the Application of IRC Section 101(j)

IRC Section 101(j)(2)(A) and (j)(4) provide exceptions that relate to “the time the contract is issued.” The Notice makes clear that, for these purposes, the policy is “issued” on the later of (1) application, (2) the effective date of coverage or (3) the formal issuance of the contract.

Satisfaction of Notice and Consent Requirements

After noting that the statute does not provide for any cure, the Notice states that the IRS will not challenge an exception based on a failure to satisfy notice and consent requirements if:

1. The policyholder made a good faith effort to satisfy the requirements *such as* by maintaining a formal system to do so;
2. The failure to satisfy the requirements was inadvertent; and
3. The failure to satisfy the requirements was discovered and corrected no later than the due date of the tax return of the policyholder for the year the policy was issued.

The Notice makes clear that notice and consent requirements may be satisfied electronically, notwithstanding the requirement in the statute that they be in writing, so long as the notice and consent meet the content requirements (*e.g.*, intent to insure, maximum amount, consent, etc.). Such an electronic system must also (1) ensure the employee receives the information transmitted; (2) make reasonably certain that the person accessing the system is the relevant employee; (3) provide for electronic signature indicating the employee’s consent; and (4) provide for hardcopy upon request of the IRS with the employer’s statement that required notice was given and consent received.

Also of particular interest is the limited shelf life of valid notice and consent: to qualify for an exception under IRC Section 101(j) an employer-owned policy must be issued before the earlier of (1) the one-year anniversary of the execution of the consent and (2) termination of the insured employee’s employment with the policyholder. If an employee irrevocably transfers a policy to its employer, no written notice and consent is required. However, if the employer subsequently increases the face amount of the insurance, notice and consent are required with respect to the additional insurance.

In addition, the Notice observes that IRC Section 101(j) provides no exception to the notice and consent requirements for a policy insuring the life of an owner-employee of a wholly owned corporation. Furthermore, a single consent can apply to more than one life insurance policy, so long as the notice of maximum amount is not exceeded.

Transition Rule and Section 1035 Exchanges

The Notice sets forth a list of changes to a policy which are *not* considered to be material for purposes of determining whether a new policy has been issued under IRC Section 101(j): (1) increases in death benefit resulting from the terms of the contract requiring no consent from the insurer or operation of IRC Section 7702; (2) administrative changes; (3) changes between general and separate accounts; or (4) changes resulting from exercise of an option or right under the original contract.

Information Reporting under Section 6039I and Form 8925

The Notice states that only policyholders “owning 1 or more employer-owned life insurance contracts” are required to file IRS Form 8925 under IRC Section 6039I. Thus, “related persons” referred to by the definition under Section 101(j) of “applicable policyholder” are not anticipated to be required to file, because such persons would not actually own an employer-owned policy.

Effective Date

The Notice is effective June 15, 2009, and asserts that the Service will not challenge a taxpayer who made a good faith effort to comply with Section 101(j) based on a reasonable interpretation of its provisions before June 15, 2009.

How is John Hancock Helping Our Clients with Regards to COLI Best Practices?

To help facilitate the ease of obtaining and tracking the notice and consent requirements, John Hancock has completed an extensive re-filing of COLI applications, to include both the CP4004 Guaranteed Issue Consent forms and the CP4003 Simplified Issue Consent forms, which have been updated to include the notice and consent requirements stipulated by COLI Best Practices.

For fully underwritten cases, John Hancock has developed a process to assist in obtaining the notice and consent requirements. This process has two options available. The first option is the “Master” approach which allows the corporation/employer to provide a written declaration that the above notice and consent requirements have been satisfied and recorded. The second option is to provide a written declaration from each insured that the above notice and consent requirements have been satisfied. Samples of these declarations are available from the John Hancock Corporate Insurance and Design Group.

Form 8925 for Reporting of Employer Owned Life Insurance Contracts

On January 15, 2008, the IRS released the final version of Form 8925, Report of Employer Owned Life Insurance Contracts, the form that must be used by policyholders under COLI Best Practices. The completed Form 8925 must be attached with the policyholder's tax return for each tax year ending after November 13, 2007 for which they hold "employer-owned life insurance contracts" that are subject to the requirements of Section 101 (j).

The following information must be provided by the policyholder on the Form:

- 1) The number of employees the policyholder had at the end of the tax year;
- 2) The number of such employees who were insured under the employer-owned life insurance contracts at the end tax year (which were issued after August 17, 2006);
- 3) The total amount of employer-owned life insurance in force at the end of the tax year for those insured employees; and
- 4) A statement that the policyholder has a valid consent for each insured employee in accordance with Section 101 (j), and if not, the total number of insured employees lacking a consent form.

Form 8925, including instructions, can be obtained through the Internal Revenue Service's website at <http://www.irs.gov/pub/irs-pdf/f8925.pdf>

For Agent Use Only. This material may not be used with the public.

This material does not constitute tax, legal or accounting advice and neither John Hancock nor any of its agents, employees or registered representatives are in the business of offering such advice. It was not intended or written for use and cannot be used by any taxpayer for the purpose of avoiding any IRS penalty. It was written to support the marketing of the transactions or topics it addresses. Anyone interested in these transactions or topics should seek advice based on his or her particular circumstances from independent professional advisors.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

MLINY06240911257

