



## NYLEX News

Premier Executive Benefits Plan Services

August, 2006

### COLI Best Practices **Legislative Alert**

#### To our clients and friends

**This issue of NYLEX News highlights the “COLI Best Practices” provisions of the Pension Protection Act of 2006. Careful planning is required to make sure that death benefits from your company-owned life insurance policies (COLI) continue to be exempt from federal income tax under these new rules. Please send comments about this newsletter, as well as suggestions for future issues, to our Stamford, CT office.**

#### SUMMARY

President Bush signed the Pension Protection Act of 2006 on August 17. This massive legislation includes substantial changes to the rules governing the funding of qualified plans and also addresses the uncertainties surrounding cash balance plans.

#### Effective Date

These new “best practices” rules generally apply to insurance contracts issued after August 17, 2006, and to existing contracts where the death benefit is materially increased or there is another material change after that date.

In addition, the COLI “best practices” provisions in the Act confirm that death benefits from COLI arrangements that conform to life insurance industry best practices will continue to be exempt from income taxation.

#### COLI BEST PRACTICES PROVISIONS

Life insurance proceeds resulting from the death of the insured generally are excluded from gross income for federal income tax purposes. This exclusion applies regardless of whether the beneficiary is an individual, corporation, the estate of the insured or some other recipient.

Before the 2006 Pension Act, no separate rules existed for the exclusion of death proceeds on employer-owned life insurance, commonly referred to as Company Owned Life Insurance, or “COLI”. In addition, for tax purposes there were no notice, consent, or specific reporting requirements for such contracts.

#### 2006 Pension Act

The 2006 Pension Act provides that death proceeds on employer-owned life insurance will continue to be excluded from taxable income, but only if:

- One of the exceptions specified in the Act is satisfied, and
- The Act’s statutory notice and consent requirements are satisfied

#### Employer-owned life insurance

The COLI Best Practices Provisions apply only to employer-owned life insurance, which means a life insurance contract: (1) owned by a person engaged in a trade or business, where (2) that person (or a related person) is a beneficiary under the contract, and where (3) the contract covers the life of an employee of the policyholder.

#### Exceptions qualifying for tax-free treatment

To satisfy the Act’s requirements for tax exclusion, any one of the following must apply:

- The insured was an employee at any time during the 12 months before his or her death;
- When the insurance contract was issued, the insured was:
  - A director;
  - A 5% or greater owner of the business;
  - One of the 5 highest paid officers;
  - An employee who received in excess of \$100,000 for 2006, adjusted annually for inflation;

- Among the 35% highest paid employees)
- The death proceeds are paid to a family member of the insured, or to the deceased's named beneficiary under the contract (other than the policyholder), or a related trust, or the estate of the insured; or
- The death proceeds are used to buy an equity interest in the policyholder from a person described in the bullet above.

### Notice and consent requirements

To qualify the death benefits for exclusion in the case of employer-owned life insurance, the Act requires that before the issuance of the insurance contract:

- The employee is notified in writing that the employer intends to insure the employee's life and the maximum face amount of the insurance contract to be issued;
- The employee provides written consent to being insured and that coverage may continue after his or her employment terminates; and
- The employee is informed in writing that the employer will be a beneficiary of any death proceeds under the policy.

In addition, employers must report annually to the IRS details about employer-owned life insurance they own.

### THE EFFECT OF THESE NEW RULES

The COLI Best Practices Provisions codify practices that many in the industry consistently have followed. NYLEX Benefits has long insisted that COLI coverage be restricted to highly compensated or managerial level employees and that consents be obtained from all individu-

als to be insured. To this extent, the new law does not introduce any new or more onerous requirements.

However, the new law does mandate that specific language be included in employer notices and in employees' consents. Employers and their advisors must exercise care to make sure these requirements are met.

### ABOUT NYLEX BENEFITS

NYL Executive Benefits LLC (NYLEX Benefits) provides supplemental executive benefit programs to a wide range of commercial clients. We focus on developing cost effective executive benefit solutions that are designed to attract, reward and retain key employees. Our services are designed to assist clients at all stages in the adoption and operation of executive benefit programs, and include:

- Initial assessment
- Plan design
- Funding
- Plan implementation
- Ongoing administration

NYLEX Benefits' professional staff includes the following professional disciplines, all dedicated to supporting our clients' programs, processes, systems and services:

- Accountants
- Actuaries
- Attorneys
- Benefit specialists
- Insurance specialists

We take great care to assure that client programs are practical and cost effective and that they are designed to achieve our clients' strategic and operational goals.

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