

ADVANCED  
MARKETS

# Key Person Insurance

A Versatile, but Underused  
Business Practice



Underwritten by  
United of Omaha Life Insurance Company  
A Mutual of Omaha Company

# What is Key Person Life Insurance?

## A solution that can help:

- Protect the business from the premature death of a key employee
- Provide the financial cushion to help recruit, hire and train a replacement
- Provide options for the business owner in the future



# Why Key Person Life Insurance?



**Life insurance provides death benefit protection and cash value liquidity to act as a financial cushion to help owners:**

- Recruit
- Hire
- Train

# Determining the “Difference-makers”

## Who are the key employees?

- Impact to operations/workflow
- Relationship managers/customer relations
- Impact to sales and profitability



# Cost of Losing a Key Employee



**Every organization incurs costs when they lose a key contributor.**

- Contractual benefits due to employment contracts
- Cost of healthcare
- Management and staff disruption
- Disruption of revenue stream
- Loss of skill and expertise
- Loss of reputation and recruiting power

# How Key Person Insurance Works



The business is the owner and beneficiary of a policy on each key employee.

# Funding With Life Insurance



- Permanent Life Insurance
- Term Life Insurance
- How much?
- Face amount up to 15 times compensation

# Why Consider a Permanent Life Policy?

## Policy cash values:

- Provide immediate, cost-effective liquidity
- Appear as an asset on the balance sheet
- May be used for various business needs
- Give the business owner options in the future



“The death benefit is  
income tax free, right?”

Follow the rules of  
Section 101(j)

# What is EOLI?



An employer-owned life insurance contract is owned by a person or entity engaged in a trade or business who is also directly or indirectly the beneficiary of the policy



Covers an employee of the trade or business on the date the contract is issued

## Why does it matter?

- For policies issued or materially modified after August 17, 2006, the death benefit is taxable over and above the premium and other amounts paid for the insurance
- Does not apply when insuring certain insureds and amounts paid to their heirs

## Who are the “certain” insureds?

- An employee of the applicable policyholder during the 12-month period prior to death

OR

- At the time the contract was ISSUED
  - Director
  - Highly compensated within meaning for 414(q) without regard to (1)(B)(ii)
    - 5% owner
    - \$160,000 in 2025
  - Among the highest paid 35% of employees

# What about amounts paid to insured's heirs?

- Amounts paid to:
  - Family member of the insured
  - Designated beneficiary other than the applicable policyholder
  - A trust for the benefit of such a family member or designated beneficiary
  - The estate of the insured
- The death benefit is used to purchase an equity interest from any of the above

Does this mean  
the amount paid to  
the family will also  
be tax free?

Not necessarily...

It might be taxable under other  
rules if considered deferred  
compensation or a taxable  
distribution from the business.

## Is that all?

They must provide written notice and obtain consent **PRIOR TO ISSUE**

- Intend to insure the employee and notifies them as to the maximum face amount for which the employee could be insured
- Employee consents and understands that coverage may continue after termination of employment
- The employer will be the beneficiary of the policy

# When is a policy issued?

Later of:

- Application
- Effective date of coverage
- Formal issuance of the contract

# Can a mistake be fixed?

- Exceptions:
  - Policyholder made a good faith effort to comply
  - Failure to satisfy was inadvertent
  - Failure was corrected no later than tax filing due date for year in which policy was issued
- Apply for a new policy
- Will a 1035 that is a “material change” allow for a new notice and consent? Unclear – client will have to consult with tax or legal advisers



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## EMPLOYER OWNED LIFE INSURANCE POLICIES

### Acknowledgement

Section 101(j) of the Internal Revenue Code ("IRC") became effective on August 18, 2006. This section provides that when an applicable policyholder (employer or related party) is the owner and beneficiary of a life insurance policy insuring the life of an employee, the death benefit may be taxable. The tax consequence can be avoided if the insured is a member of a class exempted from this treatment by IRC section 101 (j) and notice and consent requirements have been satisfied.

It is the employer's responsibility to obtain appropriate tax and legal advice regarding the tax and legal consequences of death benefits paid for employer owned life insurance. This document is not intended to provide legal or tax advice.

Employer acknowledges that if the policy applied for is or may be employer owned as defined in IRC section 101, it may be required to obtain written consent from the insured employee prior to issuance of the life insurance policy and annually file applicable tax forms with the Internal Revenue Service. The consent should include, but not be limited to, the following statements: (1) that the employee understands that life insurance on his or her life is being applied for by the employer and the maximum face amount of insurance for which the employer could be insured; (2) that the employee consents to being insured under such insurance; (3) that such insurance coverage may continue after the insured terminates employment from employer; and (4) that the employer will be the beneficiary of any proceeds payable upon the death of the employee.

Signature of Authorized Officer of Employer \_\_\_\_\_

Print Name \_\_\_\_\_

Position or Title \_\_\_\_\_ Date \_\_\_\_\_

Employer Name \_\_\_\_\_

Employee/Insured's Printed Name \_\_\_\_\_

PLEASE RETURN THE SIGNED ORIGINAL COPY TO  
 THE HOME OFFICE AND LEAVE A COPY WITH THE EMPLOYER

## EMPLOYER-OWNED LIFE INSURANCE Section 101(j) – NOTICE AND CONSENT

### Sample Document - For Attorney Use Only.

This sample form may be given to the client's legal counsel for consideration. It is not adapted to the specific circumstances or objectives of any individual client, nor has it been prepared to meet the legal requirements of any particular state.

**All legal documents should be prepared only by a licensed attorney.**

### NOTICE OF EMPLOYER'S INTENT TO INSURE EMPLOYEE'S LIFE

\_\_\_\_\_ ("Employee") is being notified by \_\_\_\_\_ ("Employer") pursuant to Internal Revenue Code Section 101(j) that:

1. Employer intends to apply for life insurance on Employee's life
2. The maximum face amount for which Employee could be insured at the time the policy is issued is \$ \_\_\_\_\_ (the actual face amount may be less)
3. Employer will be a direct or indirect beneficiary of proceeds payable on death of Employee.

### EMPLOYEE ACKNOWLEDGEMENT

Employee acknowledges receipt of the above notice and  consents  declines to:

1. The Employer purchasing life insurance on Employee's life, as stated above
2. The life insurance policy remaining in effect after Employee terminates employment with Employer.
3. The Employer being a direct or indirect beneficiary of any death proceeds payable.

\_\_\_\_\_  
 Employee Signature

\_\_\_\_\_  
 Date

\_\_\_\_\_  
 Print Name

# Tax Form 8925

Form **8925**

(Rev. September 2017)  
Department of the Treasury  
Internal Revenue Service (99)

## Report of Employer-Owned Life Insurance Contracts

OMB No. 1545-2089

▶ Attach to the policyholder's tax return. See instructions.  
▶ Go to [www.irs.gov/Form8925](http://www.irs.gov/Form8925) for the latest information.

Attachment  
Sequence No. **160**

Name(s) shown on return		Identifying number
Name of policyholder, if different from above		Identifying number, if different from above
Type of business		
<b>1</b>	Enter the number of employees the policyholder had at the end of the tax year . . . . .	<b>1</b>
<b>2</b>	Enter the number of employees included on line 1 who were insured at the end of the tax year under the policyholder's employer-owned life insurance contract(s) issued after August 17, 2006. See <i>Section 1035 exchanges</i> on page 2 for an exception . . . . .	<b>2</b>
<b>3</b>	Enter the total amount of employer-owned life insurance in force at the end of the tax year for employees who were insured under the contract(s) specified on line 2 . . . . .	<b>3</b>
<b>4a</b>	Does the policyholder have a valid consent for each employee included on line 2? See instructions . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No	
<b>b</b>	If "No," enter the number of employees included on line 2 for whom the policyholder does not have a valid consent . . . . .	<b>4b</b>

Section references are to the Internal Revenue Code unless otherwise noted.

### Future Developments

For the latest information about developments related to Form 8925 and its instructions, such as legislation enacted after they were published, go to [www.irs.gov/Form8925](http://www.irs.gov/Form8925).

### General Instructions

#### Purpose of Form

Use Form 8925 to report the number of employees covered by employer-owned life insurance contracts issued after August 17, 2006, and the total amount of employer-owned life insurance in force on those employees at the end of the tax year. Policyholders must also indicate whether a valid consent has been received from each covered employee, and the number of covered employees for which a valid consent has not been received.

**Policyholder.** For purposes of Form 8925 and these instructions, a policyholder is an "applicable policyholder" as defined in section 101(j)(3)(B). Generally, a policyholder is the person who owns the employer-owned life insurance contract, and who is (a) engaged in a trade or business that employs the person insured under the employer-owned life insurance contract and (b) the direct or indirect beneficiary of the employer-owned life insurance contract.

**Related person.** A related person is considered a policyholder if that person is (a) related to the policyholder (defined earlier) under sections 267(b) or 707(b) (1), or (b) engaged in a trade or business under common control with the policyholder. See sections 52(a) and (b).

**Employee.** Employee includes an officer, director, or highly compensated employee under section 414(q).

**Insured.** An individual must be a U.S.

The written notification must include a disclosure of the face amount of life insurance, either in dollars or as a multiple of salary, that the policyholder reasonably expects to purchase with regard to the employee during the course of the employee's tenure. Additional notice and consent are required if the aggregate face amount of the employer-owned life insurance contracts with regard to an employee exceeds the amount of which the employee was given notice and to which the employee consented. See Q&A-9 and Q&A-12 in Notice 2009-48.

**2.** Provide written notification to the employee that the policyholder will be a beneficiary of any proceeds payable upon the death of the employee.

**3.** Receive written consent from the employee. See *Valid consent* under the instructions for line 4a.

**Electronic notification and consent.** The written notification and consent

# Meet Your Advanced Markets Partners



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