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A Message from the Section Chair

Philip L. Burke

It is a privilege and an honor to be able to represent this Section in the coming year. I would like to thank and commend my predecessor, Colleen Carew, for a tremendous job during her tenure. Not only was the Fall Meeting in Philadelphia a smashing success, but under her leadership the Section was able to have five of its legislative proposals approved by the State Bar for submission to the Legislature (more on these below). While those individuals that sacrificed substantial amounts of "blood, sweat and tears" in preparing the legislation and various reports also deserve our thanks and gratitude (these individuals were thanked in the e-mail that the Section sent to all of its members back on January 30th), I am sure that Colleen's leadership had a great deal to do with the overall success of these proposals.

I would also like to thank and congratulate Ronni Davidowitz for an excellent Annual Meeting Program in New York City on January 24th. The presentations and the materials were first class from start to finish and the materials will continue to provide a valuable resource for those of us working in the charitable giving arenas.

There are still a great number of things that need to be done in the coming year. There are many legislative proposals that the Section is actively working on, several of which will be addressed with the Legislature at "Lobbying Day" in Albany. This should take place in the next month or two. We will report on the progress of these and other proposals in the coming months.

As indicated above, five of our legislative proposals were approved by the Executive Committee of the State Bar and/or the House of Delegates. These bills will now be presented to the Legislature for review and, hopefully, passage. To reiterate, these bills are as follows:

1. An Amendment to SCPA 2211 to provide for disclosure of documents prior to the pre-objection examination of an accounting fiduciary;

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New I.R.C. § 101(j) EOLI Rules: Important Planning Considerations

By Robert J. Adler

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (PPA 06) into law. One of the more important changes involves the income tax treatment of employer-owned life insurance. This article examines these new rules and explores some of the planning considerations and potential tax traps they engender.

Background

Businesses buy life insurance for a variety of reasons, most commonly to protect against the death of key employees, to accumulate cash value for future funding of employee benefit plans, or to provide funding for a buy-sell agreement. Life insurance owned by a business has become known as COLI, or company-owned life insurance. Life insurance, in general, is unique as a savings vehicle, since the inside build-up of cash value is free of income taxes, as is the death benefit.

Prior to 1997 taxpayers often leveraged these benefits still further by financing policy premiums with loans against the policies and deducting the interest on the loans. Taken to its extreme, such an arrangement could effectively produce an annual net cash flow gain, through reduced corporate income tax, with no net cash outlay (after the initial policy load years). At some point along the way aggressive corporate CFOs realized that if the company can generate positive cash flow through leveraging the policies it held for otherwise legitimate business reasons (such as key man protection), why not multiply that tax savings benefit several-fold by insuring the lives of as many employees as possible. Large corporations could potentially save millions in taxes through leveraged coverage of hundreds of employees. Winn-Dixie Stores, Inc., a large public corporation, took such a course in 1993, insuring more than 30,000 employees! Through situations such as this, leveraged COLI programs were sometimes referred to as "janitor insurance."

Legislation in 1986 limited the interest deduction for loans against COLI policies, and the deduction was eliminated altogether in 1996. Although the interest leverage aspect of COLI policies was eliminated, the "janitor insurance" aspect was not. In other words, companies were still free to take out insurance policies on the lives of potentially thousands of employees and receive the death benefits completely tax-free. Several of such arrangements have been struck down in court cases. The insurance policies were ruled invalid under applicable state law on the grounds that the company did not have a sufficient insurable interest in a lower-level employee's life. Eventually this aggressive COLI practice attracted widespread negative publicity; the most offensive situations being those in which a corporation would effectively realize a cash windfall upon the death of a former employee, even decades after the individual had left the company. Moreover, the individual may not even have been informed by the company while he was employed there that it had purchased a policy on his life. It was these types of situations that eventually prompted Congress to act to discourage COLI abuse by adopting new § 101(j) as part of PPA 06. With a variety of broadly encompassing exceptions, all discussed below, § 101(j) requires income recognition for life insurance proceeds received by an employer upon the death of an employee (or former employee), to the extent that the policy proceeds exceed the aggregate premiums and other costs paid by the employer in connection with the policy.

General Rule of I.R.C. § 101(j)

Under new I.R.C. § 101(j) death benefits paid on an "employer-owned life insurance contract" (EOLI), in excess of the costs of the contract, are no longer tax-free under the broad death benefit exclusion principle of § 101(a), unless certain notice and consent requirements are met and the policy fits within one of the exceptions set forth.

I.R.C. § 101(j), added by the Act, states a simple general rule:

> In the case of an employer-owned life insurance contract, the amount excluded from gross income of an applicable policyholder [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.

Though simple, this is a radical departure from the rule of § 101(a), under which all proceeds from a life policy are excludable from income. In effect, the new § 101(j) is consistent with the rule governing products such as annuities: only the investment in the contract is excludable.

Employer-Owned Life Insurance Contract (EOLI)

New Code § 101(j) applies to all "employer-owned life insurance contracts," which it defines as a life insurance contract which—

> (i) is owned by a person engaged in a trade or business and under which such person (or a related person described in subparagraph (B)(ii)) is directly or indirectly a beneficiary under the contract, and
>
> (ii) covers the life of an insured who is an employee with respect to the trade or business of the applicable policyholder on the date the contract is issued.

Thus, § 101(j) takes in every kind of life contract under which the insured is the employee of the owner-beneficiary—from the most abusive form of janitor insurance to the most legitimate and business-appropriate key executive coverage. The statute proceeds by carving out two sets of exceptions from this general rule of income inclusion and couples those exceptions to employee notice and consent requirements.

Where the notice and consent requirements are met, and an exception is applicable, the entire death benefit will be excluded from the beneficiary's gross income. Any one of several exceptions may apply, but the notice and consent requirements must be met in order for any exception to apply.

Notice and Consent Requirements

Section 101(j) requires that, in order for an exception to the income-recognition rule to be applicable, the employee must be notified in writing of the following, before the issuance of the insurance contract:

- notice that the applicable policyholder intends to insure the employee's life;
- notice that an applicable policyholder will be a beneficiary of any proceeds payable upon the death of the employee;
- notice of the maximum face amount for which the employee could be insured at the time the contract is issued.

Additionally, the employee must provide written consent to being insured under the contract and that such coverage may continue after the insured terminates employment.

Exceptions to the General Rule of I.R.C. § 101(j)

The exceptions (which describe when full exclusion of death benefits still applies) make provision for most, if not all, circumstances wherein the employer can be said to have a traditional insurable interest.

Key Personnel

The first situation one would wish to accommodate is that of key executive insurance. Amounts received as a result of the death of a key executive should, intuitively, remain fully excludable. Section 101(j) seeks to achieve this result (without using the term "key executive") with an exception for the following insured persons:

- one who was an employee at any time during the 12-month period before the insured's death; or
- one who is, at the time the contract is issued

  1. a director;
  2. a highly compensated employee within the meaning of section 414(q) (without regard to paragraph (1)(B)(ii) thereof); or
  3. a highly compensated individual within the meaning of section 105(h)(5), except that "35 percent" shall be substituted for "25 percent" in subparagraph (C) thereof.

(Under § 414(q) as applied here, an individual is a highly compensated employee (HCE) if he is a 5 percent owner during the tax year or the preceding year, or had compensation over $95,000 (in 2005—as indexed for inflation); under § 105(h)(5) as applied here, a person is a highly compensated individual if he is an officer, a 10 percent owner, or in the highest 35 percent paid bracket.)

The provisions in the second bullet point pretty well capture the employees we would intuitively think of as key.

The provisions in the first bullet point provide an exception if the insured was an employee at any time during the 12-month period before his death, a logical exception but not tied to notions of insurable interest. This still allows for "janitor insurance," but the death benefit exclusion applies only if the employee has received the required notice, consented to the arrangement, and dies no later than 12 months after termination of employment, requirements that did not apply under prior law. As a practical matter, state insurable interest laws, together with the loss of the income exclusion for the death benefit once the employee has been retired for more than 12 months, make "janitor insurance" a thing of the past.

Proceeds Going to Parties Other Than the Employer (The "Beneficiaries" Exception)

The second set of exceptions is straightforward, permitting full exclusion where parties other than the employer are the policy beneficiaries (as when life insurance is a straightforward employee benefit), or where the policy proceeds are applied to funding a buy-sell agreement. Specifically, there is no income inclusion when the policy amount is paid to:

- any individual who is the designated beneficiary of the policy (other than the employer policyholder);
- a member of the family of the insured (per I.R.C. § 267(c)(4); this means brothers and sisters, spouse, ancestors, and lineal descendants);
- a trust established for the benefit of any such person; or
- the estate of the insured.

Finally, there is full exclusion when the policy amount is used to purchase "an equity (or capital or profits) interest" in the employer policyholder from any person described in the above exceptions. This will typically be the case in a buy-sell agreement.

Special Definitions

The statute contains two definitions. "Employee" includes officers, directors, and highly compensated individuals as defined by I.R.C. § 414(q). And "insured" is limited to United States citizens or residents (and covers both individuals under a joint insurance contract).

Effective Date

Section 101(j) is effective from the date of enactment, August 17, 2006, but it does not apply to a contract issued pursuant to a § 1035 exchange, for a contract issued before that date. Any "material increase in the death benefit or other material change" in a grandfathered contract after the effective date will be treated as a new contract subject to § 101(j). The Joint Committee on Taxation's Technical Explanation of H.R. 4 (the version of the bill passed by the House) states that certain increases in the death benefit—those resulting from the application of I.R.C. § 7702, or from the normal operation of the contract (e.g., when dividends are used to purchase paid-up additions), or from market performance or the contract design—are not material. Furthermore, certain changes in the contract, including administrative changes, changes from general to separate account, or changes due to the exercise of an option or right originally granted under the contract, are not material.

Reliance on the § 1035 Exchange Exception to the Effective Date Is Risky

Because a § 1035 exchange will almost always involve a "material increase in the death benefit or other material change" cautious advisors will counsel their clients to treat almost all exchanges of EOLI contracts as if the § 1035 exchange exception were not available (that is, they will counsel their clients to follow the new PPA 06 requirements even in the 1035 exchange context).

Reporting Requirements

PPA 06 adds a new § 6039I to the Internal Revenue Code establishing reporting requirements for owners of employer-owned life insurance (as defined in new § 101(j)). An applicable policyholder must report:

- the number of its employees at the end of the year;
- the number of such employees insured under employer-owned insurance contracts at the end of the year;
- the total amount of insurance in force at the end of the year under such contracts;
- the name, address, and taxpayer ID of the applicable policyholder and the type of business in which it is engaged;
- a statement that the applicable policyholder has a valid consent for each insured employee (or the number of insured employees from whom consent was not obtained).

Employers must keep records sufficient to demonstrate their compliance with these requirements.

Planning Considerations and Potential Tax Traps

Notice and Consent

Probably the most important new planning element that emerges from new § 101(j) is the need to obtain the consent of the insured party prior to the issuance of an EOLI policy. This is the case not only for lower-level employees, where the insurable interest might be questionable, but even for the highest level executives and key personnel, where there is no insurable-interest issue and the legitimate business reasons for the insurance are obvious.

Advisors should incorporate into the documentation leading up to the issuance of the insurance contract a form designed to satisfy the § 101(j) notice and consent requirement. Such a form, which must be signed by the proposed insured prior to actual issuance of the contract, might read as follows:

[Note: The form below is for illustrative purposes ONLY. Contact the applicable issuer/carrier/life insurance advisor for all forms to be used in the application process.]

> *I, [name of insured], do hereby acknowledge that I have received notice that I am to be the insured party under a life insurance contract (policy) to be purchased and owned by [name of policyholder]. I have also been notified that (a) the maximum amount of insurance coverage under the aforementioned contract, as of the date of issuance, will be $_______; and (b) [name of beneficiary] will be the beneficiary of any policy proceeds payable upon my death.*
>
> *Having received notice, as stated above, I do hereby consent to being insured under the aforementioned insurance contract, and I do further consent to the continuance of such insurance coverage even after the termination of my employment or other relationship with the policyholder, [name of policyholder].*
>
> ___________ *[Print Name]* ______ *[Date]*
>
> __________________________ *[Signature]*

It should be noted that the exceptions to the income-inclusion rule of § 101(j), as summarized above (the insured's status exception (i.e., key personnel), the beneficiary exception and the buy-sell exception) *will not apply if the notice and consent requirements are not met*. Thus, the importance of having this notice and consent document signed *prior to the issuance of the insurance contract* cannot be overemphasized. Unless the IRS announces some form of hardship relief to the pre-issuance time deadline, consents executed after the date of issuance will be ineffective, and the policy death benefit (net of the cumulative costs of the policy) will be taxable to the policyholder.

In instances where a failure to timely satisfy the notice and consent requirement is subsequently discovered, the problem can presumably be cured by a cancellation of the original policy and reissuance of a new one following execution of the notice and consent by the insured. This will likely involve added costs, and potential income taxation if, at the time that the administrative slip-up is discovered, the surrender value of the original policy has grown to a level in excess of the cumulative costs of the policy. (A § 1035 tax-deferred exchange transaction runs a serious risk that the IRS would consider the date of the original policy as the operative date of issuance of the contract for purposes of § 101(j). This position is supported by the fact that policies issued in § 1035 exchanges for policies grandfathered from the new § 101(j) rules are treated as retaining the grandfathered status. On the other hand the grandfathering analogy would not be applicable if the exchange involved a "material increase in the death benefit *or other material change.*")

Potential Application of § 101(j) to Common Employee Insurance Arrangements

The application of the new § 101(j) to most typical EOLI situations is quite straightforward: if a business acquires a life insurance policy on the life of an employee, this is "employer-owned life insurance" within the definition of § 101(j)(3), and the death benefit is taxable unless the notice and consent requirements have been met and one of the exceptions applies.

There are, however, a variety of situations when life insurance is acquired in a business setting where the business itself is not the actual owner of the policy. Examples include policies owned by VEBAs, rabbi trusts, secular trusts, and business owners individually, under cross-purchase buy-sell agreements. In such situations, the question arises whether such a policy is technically an "employer-owned insurance contract" within the coverage of § 101(j).

Buy-Sell Arrangements

Life insurance is commonly utilized to provide funds to complete the buy-out of a business interest from the estate or heirs of a deceased co-owner, pursuant to a buy-sell agreement. Insurance-funded buy-sell arrangements may in some instances be impacted by new § 101(j). In situations where the business entity is the owner and beneficiary of the policy, this would be an "employer-owned life insurance contract" under § 101(j)(3) if the insured party was an employee or director of the policyholder entity (or of a related party to the policyholder). Thus, one of the exceptions under § 101(j) would have to be applicable in order to avoid taxation of the death benefit. In the vast majority of cases where insurance is purchased by a business to fund a buy-sell agreement, one or more of the exceptions will apply. Almost by definition, the § 101(j)(2)(B)(ii) exception would apply since the insurance proceeds would be used "to purchase an equity (or capital or profits) interest" in the policyholder company from the insured's estate or heirs. Additionally, the insured will most likely have been a material owner of the business [§ 101(j)(2), exception (A)(ii)]). However, again, the notice and consent requirements must be complied with in order for any of the exceptions to apply, and the IRS reporting requirements would apply since an "employer-owned life insurance contract" is involved.

In the cross-purchase type of buy-sell arrangement, where the insurance policies are not owned by the business entity, but by the individual owners of the entity who are parties to the agreement, the analysis is different. An interesting technical question arises as to whether the policy falls within the definition of "employer-owner life insurance contract," which is a contract—

> owned by a person engaged in a trade or business and under which such person (or a related person described in subparagraph (B)(ii)) is directly or indirectly a beneficiary under the contract . . . [§ 101(j)(3)(A)(i)]

Subparagraph (B)(ii) describes "related persons" as those engaged in businesses having common control (within the meaning of Code § 52(a) or (b)) and persons having a relationship specified in Code § 267(b) or § 707(b)(1). In general, these sections cover family relationships and control relationships with corporations and partnerships. For example, an individual owning more than 50% of a corporation's stock would be a related person with respect to the corporation and vice versa. An individual and his brother would be "related persons."

In a cross-purchase buy-sell arrangement the policy is not owned by a person engaged in a trade or business (that "person" being the business entity—not the individual owners). Industry commentators have stated that a policy may be an employer-owned contract if it is owned by a person related to the business entity; for example, an individual who owns more than 50% of the company's stock. However, under a strict technical-grammatical reading of § 101(j) this appears incorrect.

Is There a Drafting Error in the I.R.C. § 101(j) Legislation?

The parenthetical "related person" clause in the above-quoted definition of "employer-owned life insurance contract" only applies with respect to the beneficiary, and not to the policyholder. While this may be technically and grammatically true, it appears that it may have been a drafting error in the § 101(j) legislation. One would think that the parenthetical clause referring to related persons should have been placed immediately after the phrase "a person engaged in a trade or business." Then it would be clear that even if a policy is not owned by the employer itself, if it is owned by a related person it will be considered an "employer-owned insurance contract" under § 101(j)(3)(A). It seems highly unlikely that the drafters actually intended to exclude policies owned by related persons; for example, a key officer policy purchased by the controlling shareholder of the business, rather than by the corporation itself.

Thus, until this is clarified in corrective legislation, regulations or other IRS guidance, it would be most prudent, in the planning context, to treat the "related person" clause as applicable to both the policyholder and the beneficiary. On the other hand, in a situation where a taxpayer has run afoul of § 101(j) by inadvertent failure to comply with the notice and consent requirements, or failure to file reports under new § 6039I, if the policy was not owned by the employer itself, a case based upon the current literal-grammatical reading of § 101(j)(3)(A)(i) might well prevail.

Returning to the analysis of insurance-funded buy-sell agreements, if the agreement is in the form of a cross-purchase arrangement, the "related person" issue comes into play, since the policies are not owned by the company itself. If we assume that the related person provision applies with respect to the policy owner, then if any of the cross-purchase agreement parties owns more than a 50% interest in the business, the policy held by that party will be subject to § 101(j) if the insured person was an employee of the business when the policy was issued.

Regardless of the fact that some insurance policies issued pursuant to cross-purchase buy-sell arrangements may not be subject to § 101(j), complying with the notice and consent and reporting requirements in all buy-sell situations is probably a better planning approach than establishing a groundwork for later contending that § 101(j) does not apply. If the notice and consent requirements are met, one or more of the § 101(j) exceptions is likely to apply in most buy-sell scenarios.

Nonqualified Deferred Compensation Trusts

Rabbi trusts are frequently used to hold assets set aside by an employer to fund a nonqualified deferred compensation arrangement. Because these trusts are subject to claims of the employer's creditors, the asset pool is considered owned by the employer, and neither employer contributions nor income generated in the trust is taxable to the employee-beneficiary. Thus, trust income is taxable to the employer. Life insurance is often purchased in rabbi trusts, providing tax-free build-up of the asset pool.

Is a life insurance contract owned by a rabbi trust to be considered an "employer-owned life insurance contract" under new § 101(j)? It is true that the trust is its own legal entity, technically separate from the employer; but it is a grantor trust, whose assets are deemed, for tax purposes, to belong to the employer.

For this reason it is likely that the IRS would not view the rabbi trust as a separate entity when looking at whether the insurance contract is or is not employer-owned. Accordingly, the § 101(j) notice and consent provisions should be complied with before the issuance of a life insurance policy in a rabbi trust.

Secular Trusts

If the trust established to fund a deferred compensation arrangement is a so-called secular trust, then the foregoing analysis does not apply. Unlike a rabbi trust, a secular trust is not a grantor trust. It is independent of the employer and not subject to the claims to the employer's creditors. An insurance contract acquired by a secular trust would not fall under the definition of "employer-owned life insurance" since the owner of the policy is not the employer. However, if the "related person" clause is deemed to apply with respect to the policyholder, the employer, as the grantor of the trust, would be considered a related person to the trust if the employer were also a fiduciary of the trust [see § 267(b)(4), as incorporated into § 101(j)(3)(B)(ii)]. This, of course would be avoided if the trust has an independent trustee.

VEBAs

A voluntary employee benefit association (VEBA) is a tax-exempt entity established to operate certain employee benefit programs. VEBAs sometimes acquire life insurance to fund benefits. If an insurance policy is held by a VEBA and the insured is an employee of a business sponsoring the VEBA, § 101(j) might come into play.

If the "related person" clause is deemed to apply with respect to the employer (a questionable conclusion, as discussed above), a policy owned by a VEBA could be deemed "employer-owned" by reason of the related-person provision of § 267(b)(9). This paragraph provides that an organization that is tax-exempt under Code § 501 is a related person with respect to a party who directly or indirectly controls the organization. A VEBA is such an exempt organization, under § 501(c)(9), and thus, the VEBA may be considered a related party to the business whose employees are participants in the VEBA. Again this analysis would apply only if the related-person clause is deemed to apply to the employer.

If a policy owned by a VEBA is ultimately considered to be an employer-owned insurance contract, and none of the exceptions under § 101(j) is applicable (e.g., due to failure to have obtained the insured's consent prior to issuance), the policy proceeds (in excess of costs) would be income, but it would not be taxable income because of the VEBA's tax-exempt status—unless it could be deemed unrelated business income, an unlikely stretch by the IRS. It should be noted, however, that even if the VEBA need not be concerned about income recognition under § 101(j), the employer would still be in the anomalous situation of having to file IRS reports under § 6039I if the insurance policy is deemed an employer-owned insurance contract.

Split-Dollar Arrangements

Split-dollar arrangements usually involve some form of sharing of interest in a life insurance policy between an employer and an employee who is the insured party. This is likely to bring new section 101(j) into play. The application of § 101(j) may depend upon the form in which the split-dollar arrangement is structured. In the so-called "endorsement" form of split-dollar the insurance policy is owned by the employer. In such a case the policy would clearly fall within the definition of "employer-owned life insurance contract" under § 101(j)(3)(A).

However, in the typical split-dollar arrangement, when the employee dies, the insurance proceeds are divided in such a way that the employer receives only a recovery of the cumulative premiums paid, and the excess is paid to the heirs or estate of the insured. If the employer receives none of the proceeds in excess of the policy costs paid, even though § 101(j) would be applicable (in cases where none of the exceptions apply), there would be no taxable income to the employer.

But what about the share of the proceeds going to the employee's beneficiary? In general, § 101(j) taxes proceeds received by an "applicable policyholder." This term is defined in § 101(j)(3)(B) as the person engaged in a trade or business (e.g., the employer) and related persons. Thus, the portion of the proceeds paid to the estate or heirs of the insured would not be taxable to them unless the recipient was a related person with respect to the employer. This could be a problem in a situation where the beneficiary with respect to the employee's share of the proceeds is a more-than-50% owner of the business. Additionally, if the insured decedent owned more than 50% of the business and that controlling interest passed to the same party (his estate, a trust, or a beneficiary), as was the recipient of the split-dollar insurance proceeds, that party would be a related person with respect to the employer-policyholder. In such situations the portion of policy proceeds going to the beneficiary might well be taxable under § 101(j) unless one of the exceptions is applicable and the notice and consent requirements were complied with.

The other form of split-dollar arrangement is referred to as "collateral assignment." Here the policy is owned by the insured employee. The employee names the beneficiary and collaterally assigns the policy to the employer as security for post-death reimbursement for the premiums, which are paid by the employer. Under such an arrangement, the policy would not be an "employer-owned life insurance contract" unless the "related person" clause is applicable and the employee falls under one of the related-person categories discussed above (e.g., a more-than-50% owner of the employer). Here again, we have the question as to whether the "related-person" clause even applies with respect to the policy owner (discussed above under the heading "Is There a Drafting Error in the I.R.C. § 101(j) Legislation?"). However, it is quite possible that § 101(j) would be interpreted by the IRS to apply to a policy issued pursuant to a collateral-assignment split-dollar arrangement if the employee-policyholder fell within a "related person" category, the most commonly applicable being: more-than-50% owner of the employer.

Conclusion

The foregoing material has examined a variety of business situations in which insurance covering the life of an employee may or may not be subject to the provisions of new § 101(j). In situations where § 101(j) is applicable, the tax consequences can be quite serious—income taxation of policy proceeds (net of cumulative costs) at ordinary-income rates upon the death of the insured. However, because the § 101(j) legislation was aimed primarily at abusive situations (e.g., so-called "janitor insurance"), the exceptions to its application are intended to protect most legitimate and commonly utilized employer insurance arrangements.

In the planning context the following two very important points are paramount:

1) While many employee insurance situations may appear not to be covered by § 101 because the insurance contract is not owned by the employer, there is a serious risk that in some of these cases, the IRS will seek to apply the related-party clause, with the result that the policy would be treated as an "employer-owned life insurance contract" under § 101(j)(3)(A).

2) If § 101(j) is deemed applicable, most of the common employee insurance arrangements will qualify for one or more of the exceptions. Although the exceptions provided in § 101(j) will provide safe harbor in most situations, compliance with the notice and consent requirement is an all-important prerequisite—**failure to provide notice of coverage and obtain the employee's written consent prior to the issuance of the contract will effectively bar reliance on any of the exceptions. The policy will forever retain the taint and its death benefit (in excess of cumulative costs) will ultimately be taxed as ordinary income.** Thus, as a matter of prudence, until the IRS more clearly delineates those situations it considers outside the scope of § 101(j), notice and consent forms should become part of the routine paperwork executed prior to the issuance of any policy in which an employment relationship is involved.

It should be noted that even if notice and consent are timely given, and § 101(j) is considered put to rest because one of the safe harbor exceptions clearly applies, there still remains the annual reporting requirement under new § 6039I. (These are spelled out above under the heading "Reporting Requirements.").

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Trusts and Estates Law Section

SPRING MEETING

April 19-20, 2007

Hyatt Regency • Binghamton, NY