



What Tax Issues Must I Understand Regarding Life Insurance in Retirement Plans?

Adding life insurance to a retirement plan is a time-honored strategy for a Plan to provide enhanced survivor benefits on a tax-favored basis. However, before a “qualified” life insurance policy is considered, you should first be familiar with some general compliance and tax issues:

1. The Plan Documents must permit the purchase of life insurance.
2. Unless, in the case of some profit sharing plans, a Plan has “aged” money, the amount of premium allocable to life insurance must satisfy the “incidental benefit test” (*see “How Much Life Insurance Can I Buy In My Retirement Plan?” MK-11039*).
3. Generally, life insurance death proceeds are includable in an insured’s estate for estate tax purposes.
4. Life insurance coverage cannot continue inside the plan after the participant’s termination of service (*see “Beyond Retirement or Separation from Service,” MK-10417*).
5. The cost of life insurance protection (commonly referred to as “PS 58” cost) provided under the Plan must be included in the employee’s gross income for the tax year in which deductible employer contributions or trust income is used to purchase life insurance protection.
6. A Beneficiary pays income tax on life insurance death proceeds equal to cash value just prior to death, minus the sum of the term costs of life insurance protection previously taxed to the employee. However, if the deceased was an owner-employee, the previously taxed term costs cannot be subtracted.

At SAI, we make adding life insurance easy. Our prototype Plan & Trust documents contain specific life insurance clauses to include “aged money” for profit sharing plans. We help our clients ensure that policies remain incidental to the Plan and will advise you if there is a problem. At SAI, service is our only business.

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