Elite Marketing Group

Service, Solutions and Integrity Building the future together!

"When a C or S-corporation distributes a life insurance policy to an employee, the corporation recognizes gain as if it sold the policy for its fair market value."

What?!?
You Have To Pay Tax On The Gain In A Life Insurance Policy?

There is an opportunity in today's business planning marketplace that seems to be flying under the radar. It is an excellent opportunity to bring value to your business-owner clients who are taxed as an LLC, LLP or Partnership. Credit for bringing this planning opportunity to us belongs to Bob Ritter at InsMark.

The specific tax issue involves cash value life insurance owned by a Partnership, LLP, or LLC on the life of a partner or member for buy-sell and/or indemnification purposes. If the policy is transferred to the insured partner or member at retirement, what are the income tax consequences to both parties?

Each of the three entities noted above can elect taxation as a partnership, an S-corporation or a C-corporation. Virtually all of them choose partnership taxation. The plan as outlined below only works for LLCs, LLPs and Partnerships that make the partnership election.

The Internal Revenue Code (IRC) sections governing partnership distributions is different from the one governing corporations. When a C or S-corporation distributes a life insurance policy to an employee, the corporation recognizes gain as if it sold the policy for its fair market value. When partnership taxation is involved, the general rule is one of deferral, i.e., no gain is recognized (IRC Sec. 731(b)).

The partner (or member) receiving the policy recognizes no gain (IRC Sec. 731(a)). Instead, any gain is recognized only if the partner (or member) surrenders, lapses or sells the policy.

In other words, the Partnership's (or LLC's or LLP's) basis is transferred to the partner (or member), and the transfer has no tax consequences to either party.1

The partner's (or member's) basis in the policy cannot exceed the adjusted basis of his/her interest in the business (IRC Sec. 732(a)). Post-retirement cash flow activity by the partner (or member) typically involves policy loans which are not taxable events and do not affect basis, so the transferred policy's basis is generally of no consequence unless it is surrendered, lapsed, or sold in a life settlement transaction.

There is no income tax due on the death proceeds of the life insurance. The foundation for this special treatment is IRC Sec. 101(a)(1). This statute provides that the proceeds of life insurance maturing as a death claim are exempt from federal income tax. This exemption applies to the full death benefit, including any cash value component whether loans exist or not.

Modern life insurance policies are designed to last until age 120 or the prior death of the insured. The avoidance of income tax entirely is the secret to the effectiveness of this planning. Let's look at the steps that have to be followed:

- The Partnership, LLP, or LLC purchases life insurance on selected partners (or members) for needed buy-sell purposes. With some plans, the death benefit is exclusively allocated to indemnify the business against the loss of the member (or partner), although some arrangements use both strategies;

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- Maximum-funded cash value life insurance is paid for by the Partnership, LLP or LLC;
- No premiums are scheduled after retirement;
- Policy ownership is transferred to each partner (or member) by way of a K-1 distribution at retirement (or at a different date or event if agreeable to all parties to the transaction);
- Each partner (or member) uses secured policy loans in post-retirement years to produce tax free retirement cash flow;
- Each partner (or member) keeps the policy in force until death.

Make sense? If you want to find out more about this opportunity, give us a call and we can design a strategy for your situation.

Great Western Final Expense

The death of a loved one will undoubtedly bring hardship to survivors. Too frequently, the financial hardship compounds this already emotionally tough time. However, the financial loss can be minimized or eliminated altogether with adequate life insurance. A final expense policy can be used to cover not just funeral expenses, but also the expenses associated with estate settlement costs, medical bills and outstanding debts.

We are excited to announce the addition of Great Western Insurance Company as a new carrier. They offer one of the most competitive final expense products to our guaranteed and simplified issue portfolio. With a death benefit of up to $40,000 in coverage, Great Western's maximum coverage limit is one of the highest available in the final expense market.

Please check out the highlights of Great Western's Assurance Plus (level benefits) and Guaranteed Assurance (graded benefits) below and call your Elite Life Director now for more information.

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