



## 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?”* 0011039).
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,”* 0010417).
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 the cash value just prior to death, minus the sum of the PS58 costs of life insurance protection previously taxed to the employee. However, if the deceased was an owner-employee, there is no PS58 cost subtraction because these amounts were not previously taxed to the owner-employee.

At SAI, we make adding needed 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.

**SAI**  
SECURITY ADMINISTRATORS, INC.

**BINGHAMTON OFFICE:**  
105 COURT STREET  
P.O. BOX 1625  
BINGHAMTON, NY 13902-1625  
(607) 771-1180

**SYRACUSE OFFICE:**  
SUITE 200  
906 SPENCER STREET  
SYRACUSE, NY 13204  
(315) 474-8331

This publication is intended for general information purposes or to support the promotion or marketing of the Company’s products and does not constitute legal or tax advice. This publication is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed on the taxpayer under the Internal Revenue Code or any other applicable tax law. Taxpayers are advised to seek tax advice based on the taxpayer’s particular circumstances from an independent tax advisor. There are various income, gift and estate tax consequences of utilizing life insurance within a qualified plan. A decision to purchase life insurance within a qualified plan should be made after considering the tax results and your non-tax needs for insurance. We recommended that you discuss your situation with your tax and legal counsel before purchasing an insurance product within a qualified plan.

© Copyright 2012 Security Administrators, Inc. All rights reserved