



Business clients are great to have as they buy more products than an individual who works for someone else and only has personal insurance needs. We need both types of clients, but the business owner requires more coverage.

Generally, life insurance death benefits are paid income tax-free to the policy beneficiary. Since these death benefits are not taxed, Congress decided that life insurance premiums paid should not be deductible.

However, when this general life insurance “no deduction” rule is applied to businesses (i.e., corporations, partnerships, sole proprietorships, etc.) certain life insurance premium payments may become deductible.

The most commonly seen IRC deduction exceptions for life insurance you may see when working with business owner clients include the following:

1. Life insurance premiums are generally deductible by an employer if the employee receiving the life insurance coverage recognizes income for tax purposes equal to the employer paid premium (in other words, the premiums are taxable income to the employee). The employer must not be the beneficiary.
2. Life insurance premiums are paid by an employer under a group term life insurance program for employees that provides no more than \$50,000 in annual coverage are deductible (IRC Section 79 program). The employer must not be the beneficiary.

Life Insurance and the Internal Revenue Code

3. A 401(k) IRS approved retirement plan may offer life insurance as a plan asset. If a whole life policy is used, the premium may equal up to 50 percent of the employer's annual contribution (plus forfeitures, if any) for an individual plan participant. For term and universal life insurance, the cap is 25 percent of the annual employer contribution. The amount used to fund life insurance in a defined contribution qualified retirement plan meeting one of these limits is deductible by the employer. However, the plan must authorize the purchase of life insurance in the plan.
4. Generally, all contributions made by the employer sponsoring a 412(e)(3) to the plan are fully tax deductible including life insurance premiums.

The four business situations described above identify the most common opportunities for clients to deduct. The opportunities are limited, but if clients meet the IRS rules, a federal tax deduction can be available. Clients in any of the four business situations described above should seek the advice of a tax advisor regarding their specific circumstances. One additional caveat: because of the peculiar tax and ownership rules that apply to S corporations under the IRC, life insurance premium deduction planning can be much more complex than other forms of business ownership. Always send clients to their tax advisor for assistance in this arena.

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