

EXECUTIVE BENEFIT TAX UPDATE

JUNE 2002

For Friends and Clients of NCR Executive Benefit Services...

You may have seen the *Wall Street Journal* articles a few weeks ago concerning “janitor insurance” – the practice by some large companies of buying small insurance policies on thousands of employees, all the way down to the janitor. Hence the nickname. These articles were filled with the outrageousness of a corporation profiting from the life (or death) of rank-and-file or former employees. The only problem with their reporting is that the Tax Reform Act of 1996 closed the loophole that companies were using to conduct these purchases. In other words, “the Journal” was six years late!

“Janitor insurance” evolved in the decade between 1986 and 1996. In ‘86, Congress put a limit on the amount of loans a corporate owner could take against a COLI policy and still get a tax deduction for the interest payments (before ‘86, companies could deduct unlimited amounts of loan interest!). The limit is \$50,000 of loan balance per insured. Since then, some creative (a.k.a. greedy) insurance brokers and carriers figured out that another way to create lots of interest deductions was to buy as many small policies as possible, so that the \$50,000 loan limit would still provide a meaningful economic result when compared to the rest of the policy values.

For example, Wal-Mart is reported to have bought about 300,000 policies (on everybody it could call an employee), with very small average premiums (around \$1,000 each). You can do the math, but the projected tax savings created by this transaction over time was in the *\$ billions*.

Plans funded with COLI since ‘96 (including all of our client’s plans) are usually structured with no borrowing contemplated at the time of purchase. Clients can always decide to borrow from the policies in the future, but no tax-advantaged borrowing is used in the illustration or sale of the COLI. This is a conservative approach and one that has served us and our clients well.

Please call me if you’d like to talk about any of these issues or if you just have a general question. I am happy to help you address this issue with any of your accounting, legal, or financial advisors that may bring it up. My goal is to be your resource for key employee compensation and benefit planning information.