

## Advanced Planning: The 101(j) tax trap

[Music begins]

**Presenter:** 2026 marks the 20th anniversary of one of the most overlooked and potentially painful life insurance tax traps out there. If you work with business owners, you must understand the ins and outs of Internal Revenue Code Section 101 J. The good news is, it's pretty simple to understand, and I'm going to give you some simple tips to help your clients avoid those tax traps.

So, let's go.

So, what exactly is Code Section 101 J all about? Here we are focusing on employer owned life insurance policy. So, business owned life insurance policies issued or materially modified after August 17, 2006. So, August 17, 2006. We're talking about almost 20 years. This provision has been in the tax code, and many business owners and many insurance advisors unfortunately still don't know about it.

And Code Section 101 J establishes some conditions to protect the tax-free nature of the death benefit.

[Music ends]

Now, with life insurance, we love the income tax-free death benefit. It's one of the hallmarks of tax planning when it comes to life insurance. But failure to comply with 101 J generally will make the death benefit taxable.

So, to break it down a little bit more, employer-owned life insurance refers to life insurance which is owned by a trade or business. So, we're talking about, you know, generally speaking a for profit business where the business is designated beneficiary of the policy, either for all or a portion of it. And it insures an employee at the time the contract is issued. The insured is an employee.

So, let's think about some quick examples where 101 J would apply, what it would govern. One example classic would be key person insurance, where the business is the owner and beneficiary of a life insurance policy insuring the life of a key employee. Clearly that falls under code Section 101 (j). A second example, entity or stock redemption buy sell agreements where the business is the owner and beneficiary of a policy.

I can think of another example, supplemental executive retirement plans or deferred compensation arrangements. Those golden handcuff plans where the business purchases insurance on key employees or executives to fund a golden handcuff plan, and then finally, split-dollar life insurance. Split-dollar is essentially the sharing or splitting of a life insurance policy between an employer and an employee and because the business or entity has some ownership interest in the policy for a portion of the policy that is also governed by 101 J. So, if you boil it down, code Section 101 (j) governs any situation where you have the business either owning a policy or a portion of the policy, of a life insurance policy insuring the life of an employee.

[Music begins]

Clearly, code Section 101 J is a potential tax trap. And the last thing we want to do is put a business owner in a situation where a death benefit becomes taxable. So how do we help business owners navigate 101 J. And the good news is, is pretty darn easy. Really. When you boil it down it comes down to what they call notice and consent.

And, you know, in order for the employer to be in compliance and to protect the income tax free nature of a death benefit for a business owned policy, the employee must be notified in writing that the business entity intends to insure the employee's life, and they would indicate the maximum face amount for which they will be applying.

Also, the employee needs to consent to be insured under the contract, and that the coverage may continue after they terminate employment and the employee needs to be aware that the business will be the beneficiary under the policy.

[Music ends]

So, actually when you boil it down, it's very simple. And, in fact, at AuguStar we have a sample notice and consent specimen document if you'd like to have it. We are happy to share that with you. And what you can do with that document is give it to the business owner before the policy is issued and explain to them the concept of notice and consent. But at AuguStar, we don't require the document to be returned to us because we are not a party to notice and consent.

Notice and consent is between the employer and the employee. So, you as the advisor are not required to police this or send any documents back to AuguStar. But I think it would be a very good value-add to provide the sample notice and consent to your business-owner clients. And again, if you need a copy of that, let us know. We'd be happy to get it to you. It's also contained in our illustration system and in our forms catalog, and in just about all of our materials that involve any business owned life insurance concepts.

[Music begins]

So, here's the call I receive all too often. And that is the business owner never obtained written notice and consent. And now it's three, 4 or 5 years down the road. And, they have found out about this requirement, and they want to fix it. Unfortunately, the government provides very little guidance on this. They really don't allow much here.

There is the chance to fix an inadvertent failure to obtain notice and consent, but it must be, it must be corrected by the due date of the business's income tax return, for the year in which the policy was issued. So essentially, they give businesses one year to fix it, you know, the year that the policy was issued.

So, if we are two, three, 4 or 5 years down the road or longer, really, there is not a mechanism for fixing it other than potentially materially modifying the policy which would trigger notice and consent, and they could fix it then.

[Music ends]

So maybe they're going to increase the death benefit, or they're going to transfer the policy and take out a new one. But the bottom line is, in many cases, about the only way

to fix it is to take out a new policy. And obtain notice and consent prior to the new policy being issued. Now, what about the employee who leaves employment? You know, they terminate for whatever reason. Let's say they retire. The government does say that the employee, as long as they were an employee at any time during the 12-month period before death, the death benefit will still be tax-free.

However, if they were a director, highly compensated employee or owner, then the death benefit is still tax-free. If it's even more than 12 months after that. So, the highly paid key employees, officers, directors, they, they're carved out. And, the death benefit could be paid, you know, at any time after termination. And it still, still receives income tax free treatment and also, any amount of death benefit that would pay to, let's say, the spouse of the insured or immediate family member or a trust for their benefit.

If those ultimate beneficiaries, you know, to the extent the death benefit is paid to those non-business beneficiaries that satisfies 101 J. So, there are situations we could discuss if you have more questions about that. But unfortunately, the government doesn't provide much in the way of relief for noncompliance.

[Music begins]

So, there you have it. Code Section 101 J in all its glory. And really, we've only scratched the surface on this topic. So, if you need any help, please reach out to us in Advanced Planning. We love to nerd out on these topics, so if you have any questions about 101 J, notice and consent, business-owned life insurance, or any of the other topics we hinted at today, we would love to assist you.

We want to help you help business owners as much as you can so they can maximize their business values, minimize their taxes, and protect their legacy. So go out there and help as many people as you can.

**Announcer:** This podcast is designed for financial professional use only and is not for use with the general public. It is not a guarantee of success and individual results may vary. The material discussed provides general information and should not be taken as specific legal or tax advice. Clients should seek the advice of a qualified tax or legal professional for their specific situation.

If tax free loans are taken and the policy lapses, a taxable event may occur. Withdrawals, partial surrenders and loans from life insurance policies classified as modified endowment contracts may be subject to tax at the time the withdrawal or loan is taken, and if taken prior to age 59 ½, an additional 10% federal tax may apply. Withdrawals and loans reduce the death benefit and cash surrender value.

Products issued by AuguStar Life Insurance Company member of Constellation Insurance, Inc. family of companies. Product, product features and rider availability vary by state. Guarantees are based on the claims paying ability of the issue. Issuer not licensed to do business in New York.

This podcast was produced in February of 2026 and is filed as 10530LMP.

[Music ends]