REJECT THE COLI PRO-RATA INTEREST DISALLOWANCE PROPOSAL

1. **The proposal would cost jobs and hurt employees.** 75 million American families, thousands of businesses and millions of employees rely on life insurance for financial security. COLI keeps businesses running after the death of a key owner or employee, and helps finance and secure broad-based health, disability, survivor, and supplemental retirement benefits.

2. **The proposal moves in the wrong direction by discouraging sorely-needed savings and protection.** American families and businesses are not putting aside enough for protection, long-term savings, and retirement security. The last thing Congress should be considering are taxes on life insurance products or the life insurance industry that make it harder and more costly to take responsible steps.

3. **The current tax treatment of life insurance, whether owned by families or businesses, is appropriate.** Life insurance is purchased with after-tax dollars and taxed when gain is realized during the life of the insured at ordinary income rates.

4. **Congress recently reaffirmed the important benefits and appropriate tax treatment of COLI on a bipartisan basis.** Over the period from 2003 to 2006, Congress carefully examined COLI, and subsequently enacted legislation upholding its important role and tax treatment, while codifying best practices to ensure its continued responsible use.

5. **This proposal is an attack on inside buildup by proposing a tax penalty on life insurance ownership.** Current law already prohibits businesses from deducting interest for loans connected with life insurance.

PERTINENT BACKGROUND

Important benefits are provided by corporate-owned life insurance (or COLI): COLI is widely used by businesses with respect to employees in which they have an insurable interest to keep businesses running after the death of a key owner or employee. COLI also is commonly used to finance employee benefits, including broad-based health, disability, survivor, and supplemental retirement benefits. Under accounting rules of the Financial Accounting Standards Board, retiree benefit liabilities must be accrued as they are earned over the working lifetime of the employee rather than when paid after retirement. Life insurance builds an asset to offset this balance sheet liability and reassure employees and investors that the company is not making promises it cannot keep. Employers receive no tax deduction for paying COLI premiums. Employees bear no cost for COLI, yet reap substantial benefits.

Current safeguards ensure that COLI is used responsibly: Enacted in 2006, Section 101(j) of the Internal Revenue Code requires an employer to obtain informed consent before taking out life insurance on an employee. When seeking consent, the employer must notify the employee of the maximum amount of insurance that may be taken out and that the employer will be the beneficiary of the policy, both during and after employment. Section 101(j) further provides that businesses can only take out policies on an employee that is a director, a five percent owner, or a highly compensated employee (i.e., top 35% of pay). In addition, COLI is widely utilized by financial institutions under the direct authority of bank regulators, which authorize and set strict guidelines for its use precisely because of the widely accepted benefits COLI provides to these institutions and their employees.

This proposal would impose an unjustified tax on life insurance, cost jobs, and threaten employee benefits: Current law [IRC 264(a)(4)] already prohibits businesses from deducting interest on loans to purchase or carry life insurance, subject to a de minimis exception. There is nothing to suggest that companies are not fully complying with current law.

The reason Congress originally enacted a pro-rata interest deduction disallowance [IRC 264(f)] did not relate to compliance problems. It was enacted to successfully preempt Fannie Mae from initiating a broad program to insure mortgage borrowers by imposing a tax penalty for policies covering non-employees. The current proposal [to expand IRC 264(f)] would apply that tax penalty in a way that Congress never intended—on policies covering employees.

More importantly, this proposal would directly conflict with the bipartisan enactment of the COLI Best Practices Act of 2006, which recognized the vital role of COLI in protecting jobs and providing employee benefits. Instead, it would impose a tax penalty on life insurance ownership by disallowing otherwise deductible interest. For example, if a business took out life insurance to secure promised employee benefits, and fifteen years later took out an unrelated loan to expand the business and employ more people, part of the deduction for interest paid on the business expansion loan would be disallowed. There is simply no justification for such action.