

A Closer Look at

THE LAW



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Cunningham Dalman, P.C. is a full service law firm located in Holland, as well as in Douglas, Michigan. Our attorneys possess skill and experience in a broad spectrum of areas of practice, and have proudly served the lakeshore community for over 100 years.

Small Business Owners: Are you aware of the new rules regarding company-owned life insurance?

By: [P. Haans Mulder](#)
Attorney at Law

If you are a business owner or advise business owners regarding their insurance needs, you will definitely want to read this article. As you know, life insurance is an important tool for business planning. It is commonly used to fund a buy-out of one owner by the other or by the business. It is also used to plan for the unexpected death of a key employee. A third common use is to include it as a component of a deferred compensation plan for a highly compensated employee.

Because of perceived abuses in what is referred to as company-owned life insurance, Congress has stepped in to further regulate it. Unfortunately, Congress does not typically pass a law that only deals with the abuses. Its scope is often much broader and that is the case here.

All company-owned life insurance policies issued after August 17, 2006 are impacted by this change in the law. There are three parts to this change. The first involves reporting to the Internal Revenue Service. The second relates to certain employee notices and consents. The third and most problematic is the way company-owned life insurance is now taxed.

As far as the reporting requirement, all businesses must report certain information regarding company-owned life insurance annually to the Internal Revenue Service. They must also maintain records to determine if the new law has been satisfied (and to deal with an audit).

Certain notice and consents are also required. Before a company policy is issued, the business owner must notify the employee that he or she is insured under the policy and provide the face amount of the policy. Secondly, the employee must consent in writing to the issuance of the policy. Thirdly, if the employee is the beneficiary, the employee must be notified of the maximum amount that can be insured under the policy. This must be done for all policies and small business owners must maintain these records as mentioned above.

Lastly, and most importantly, this change in the law has significantly impacted the way that company-owned life insurance is taxed. The general rule was that death benefits from life insurance were not taxable. However, the life insurance is now exposed to two problems unless certain exceptions are met. The first is that the business will incur tax on the difference between the death benefit and the premiums. This can be a significant amount. If a policy is purchased for a \$1,000,000 death benefit and only \$100,000 is paid in premiums, there can be a \$900,000 gain. The second problem is almost worse in that the gain (the difference between \$1,000,000 and \$100,000) is taxed at ordinary income rates (upwards of 35%) as opposed to the much more favorable capital gain rates (at most 15%).

Congress still allows for businesses to escape the tax trap. To do so, the business must satisfy the reporting and administrative obligations that were

mentioned above (i.e. providing notice and consent). Also, the policy must fall into one of three categories. The first category is that the policy is written on the life of an employee who is employed at least twelve months prior to his or her death. The second is where the insured of the policy is a director or highly compensated employee. The third is that the death benefits of the policy are paid to an heir of the insured.

As you can see, Congress has made significant changes to the way these policies are taxed. If you are considering purchasing a life insurance policy for your business, it is advisable to consult with someone who is familiar with these requirements and make sure they are satisfied so you do not have the unexpected surprise of a substantial tax bill upon this life insurance pay out.

Who Acts for Your Company?

By: [Vince Duckworth](#)
Attorney at Law

The answer to this question may at first seem fairly simple: My company acts through its officers, directors or authorized agents. However, if you consider this question *from the perspective* of your suppliers or vendors, does the answer change? Should the answer change? Legally, it may.

Consider the following hypothetical scenario:

Your company has various suppliers and vendors. After meeting with a potential new supplier, you learn that your company might be able to save considerable expense in providing your product by changing a supplier. You inform current supplier that while you have appreciated the past business relationship, you have decided to use a different supplier. After all, “business is business.” Your supplier informs you that they too have appreciated the long term relationship and are looking forward to *several more years* of a continued relationship (at present or even escalating costs) based on a long term contract with

early termination and attorney fee provisions. After all, says your supplier, “business is business.” Frantic, you contact your attorney for advice on whether this claimed contract, signed by an employee in Receiving, purportedly on behalf of your company, is binding. The attorney’s answer: “It depends.”

Generally, contracts claimed to be entered on behalf of a corporation, which are in excess of an agent’s authorization, are not enforceable against a corporation unless the corporation later consents, or *ratifies* the contract. Ratification, however, is not limited to formal action under corporate seal. Ratification may be implied from the conduct of the officers or directors who, becoming aware of a contract’s terms, act in a way that treats the contract as binding. However, whether a corporation’s acquiescence to favorable terms of an unsanctioned contract is alone sufficient to bind the corporation will largely depend on the unique facts and circumstances of each matter, including whether it was reasonable for the vendor or supplier to believe that the

agent had the actual or apparent authority to bind the corporation – i.e., was it reasonable for the vendor to rely on a signature of somebody in Receiving?

Answering, “Who acts for my company?” -- from the perspective of your vendors and suppliers, might save you and your company from costly surprises later. Your employees and independent contractors should also be instructed on proper

vendor/supplier purchasing protocol, formalized by a Purchasing Program, so that unintended long term or unfavorable business relationships are not unwittingly fostered. In addition, reviewing periodically with your business lawyer the relationships you have with all your vendors/suppliers is also recommended, especially when you cannot answer with certainty just how your supplier or vendor sees *its* relationship with your company.