



## Guide to Accounting for Business Owned Life Insurance

There are many instances where a business will own life insurance on the life of its owners or key employees. The death benefit and cash value in a permanent life insurance policy owned by a business is a vital financial tool that may help the business:

- Survive the loss of a key person,
- Help fund the cost of a buy out on the death of an owner,
- Create an informal funding tool for a variety of executive benefit programs including salary continuation arrangements, and
- Create a formal funding tool for executive benefit programs such as split dollar economic benefit arrangements.

There are certain accounting rules that should be followed when life insurance is owned by the business. Generally, FASB 85-4 and ASC 740 (Formerly FAS 109) will provide the necessary accounting guidelines.

### Impact on the balance sheet.

- **New Ledger Entries:** There will generally be 2 accounts entered on the balance sheet. (Please note, these ledger names are not required names. You should follow the naming standards you are applying to the balance sheet.) A third entry is necessary if the business intends to surrender the policy rather than hold the policy until the death of the insured.
  - *The Life Insurance Cash Surrender Value Account*
  - *The Policy Loan Account* – which will only be used if life insurance policy loans are taken.
  - *Deferred Tax Liability Account.* The difference between cash value and total premiums paid must be entered (only where there is no intention to hold the policy until the death of the insured). See FAS 109.
- **Premium Payments:** Entries are made to the cash account to reflect the premium payments made.

Products issued by

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Guarantees are dependent upon the claims-paying ability of the issuing company.

- **Increases in Cash Value:** Entries are made to the Life Insurance Cash Surrender Value Account to report increase in the cash surrender value of the policy (if any).
- **Policy Loans<sup>1</sup>:** An entry will be made to the Policy Loan Account when a policy loan is taken by the business. The cash account will increase equal to the amount received through the loan.
- **Policy Withdrawals<sup>1</sup>:** A withdrawal will be recorded as a reduction in the life insurance cash value account. An entry in the cash account will be made, increasing the account equal to the amount received.
- **Death Received:** This will increase the cash account when the business receives the death benefit following the death of the insured owner or key employee. The life insurance cash surrender value account should be reduced to zero.

## Impact on the income statement.

### • New Ledger Entries

- Life Insurance Premium Expense Account
- Life Insurance Income Account

- **Premium Payments:** Premiums paid are recorded in the life insurance premium expense account.

- **Increases in Cash Value:** Annual increases in cash value are entered into the life insurance income account

As a practical matter, the difference between the annual increase in cash value and the annual premium paid will be reported as an item of income or expense – as appropriate.

## Example

Let's assume that ABC Inc. purchased a permanent life insurance policy on the life of Ms. A. Ms. A is one of the owner's of the business. The insurance is intended as key person protection for the business.

The premium in year 1 is \$5,000. First year cash value is \$3,200.

### Balance Sheet\*

Cash Account: Credit \$5,000  
Life Ins. Cash Value: Debit \$3,200

### Income Statement

Life Insurance premium expense account: \$5,000  
Life Insurance income account: \$3,200

Let's see what this might look like in year 5. Assume the premium paid is \$5,000. The total cash value is \$25,020 with the increase in years 5 being \$5,020.

### Balance Sheet

Cash Account: Credit \$5,000  
Life Ins. Cash Value: Debit \$25,020

### Income Statement

Life Insurance premium expense account: \$5,000  
Life Insurance income account: \$5,020

\* Please note – the impact on business retained earnings may be a reduction in retained earnings, neutral or may increase retained earnings. This is a hypothetical example for illustrative purposes only - not representative of any particular insurance policy.

## Conclusion

The use of Life Insurance may be a key financial decision for your business. Understanding its impact on the financial statements of your business is an important element in making a decision on the use of a business owned life insurance policy.

Please note, the results described as to taxation, deductibility of premiums and effect of death benefits and cash value changes can vary from the accounting treatment per ASC 7840 (formerly FAS 109).

1. Policy loans and withdrawals reduce the policy's cash value and death benefit and may result in a taxable event. Surrender charges may reduce the policy's cash value in early years.