

Details of the Tax Consequences When the Policy is Transferred to the Non-Shareholder Executive

Plan Sponsor: Town and Country Auto Group
S Corporation

Form of Transaction (Key Executive Coverage with Deferred Transfer of Policy to Executive as Compensation)	Policy Transfer to Executive is Illustrated at Beginning of Year 11	S Corporation (Shareholder) Tax Bracket 40.00%	Executive's Tax Bracket 40.00%
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Transfer Details:

Year the transfer is illustrated: Beginning of year 11
 Accumulation value of policy when transferred: \$877,189
 S Corporation's cumulative premiums prior to transfer: \$700,000
 Executive's cumulative premiums prior to transfer: \$0

S Corporation (Shareholder) Transfer Tax Consequences:

When the policy is transferred, Shareholders must recognize gain to the extent that the policy value exceeds the S Corporation's premium payments; however, Shareholders are entitled to a deduction equal to the amount the executive includes in income on the transfer -- which is generally approximated by the policy value without regard to any surrender charges (IRS Refv. Proc. 2005-25).

Therefore, for this case:

1. Shareholders have a taxable gain of the difference between \$877,189 (accumulation value of policy) and \$700,000 (S Corporation's cumulative premium share) which equals \$177,189 in taxable gain. $\$177,189 \times 40.00\%$ (assumed tax bracket of shareholders) = \$70,876 of income tax due.
2. In addition, the shareholders have an income tax deduction of the difference between \$877,189 (policy accumulation value) and \$0 (Executive's cumulative premium share) which equals \$877,189 in taxable gain. $\$877,189 \times 40.00\% = \$350,876$ of income tax savings.
3. $\$350,876$ of income tax savings less $\$70,876$ of income tax due = $\$280,000$ of net income tax savings to the shareholders at transfer.

Executive's Transfer Tax Consequences:

The executive has taxable income to the extent of the policy's fair market value (IRC Section 83) which is generally approximated by the policy's accumulation value without reduction for surrender charges (IRS Rev. Proc. 2005-25).

Therefore, for this case:

1. The executive has a taxable income of \$877,189 (the policy accumulation value).
2. $\$877,189 \times 40.00\% = \$350,876$ of income tax due.
3. The executive has basis in the policy of \$877,189 (the amount of taxable income).

Note: Any premium payments, increase in policy values, or policy activity (loans, withdrawals, etc.) in the year of transfer are presumed to occur after the transfer takes place.