Liz Pulliam Weston

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The Basics

Does your boss want you dead?

'Dead peasants' insurance pays your employer a secret, tax-free windfall when you die. Insurers have sold millions of policies to companies such as Dow Chemical.

By Liz Pulliam Weston

Right now, your company could have a life insurance policy on you that you know nothing about. When you die -- perhaps years after you leave your employer -- the tax-free proceeds from this policy wouldnt go to your family. The money would go to the company.

Whats more, the company might use this policy to pay for retirement benefits and other perks not for you or your fellow workers, but for your companys top executives.

Sound outrageous? Such corporate-owned life insurance is also big business:

- Companies pay a whopping $8 billion in premiums each year for such coverage, according to the American Council of Life Insurers, a trade group.
- The policies make up more than 20% of the all the life insurance sold each year.
- Companies expect to reap more than $9 billion in tax breaks from these policies over the next five years. The policies are treated as whole life policies. So, companies can borrow against the policies (though the IRS won't let them write off the interest). And the death benefits are tax-free.

Hundreds of companies -- including Dow Chemical, Procter & Gamble, Wal-Mart, Walt Disney and Winn-Dixie -- have purchased this insurance on more than 6 million rank-and-file workers.

These policies, nicknamed dead janitors or dead peasants insurance, soared in popularity after many states cleared the way for them in the 1980s. Congress recently tried to crack down on the practice, to the howls of the insurance industry -- which earlier this year managed to derail reforms.

The policies have generated lawsuits by survivors

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who got little or nothing when insured workers died. A couple of examples:

Jane St. John had two children and was pregnant with a third when her husband, a butcher at a Winn-Dixie store, was killed in an auto accident. When the Killeen, Texas, woman called the company to ask about insurance, she said she was told about a $17,500 policy to which she was entitled. St. John said Winn-Dixie told her nothing about the $102,000 the company collected from a corporate-owned policy on his life. She found out about it this summer, eight years after his death, from a lawyer who researched court records. The idea that the company would secretly insure lives, and then not share the benefits with the families, "is sick," she said. "That is creepy."

Mike Rice was a 48-year-old assistant manager when he died of a massive heart attack at the Wal-Mart store in Tilton, N.H. His widow, Vicki, became the lead plaintiff in a class-action lawsuit against the company after she discovered Wal-Mart collected $300,000 from a life insurance policy it owned on him. Vicki Rice believes job-related stress contributed to the heart attack and says it is totally immoral for Wal-Mart to profit from his death.

In a lot of circumstances, the families dont get anything, said attorney Mike Myers of Houstons McClanahan & Clearman, which represents survivors suing companies over corporate-owned policies. The company tries its hardest to keep the policy a secret.

Labor leaders and some lawmakers have denounced the policies as unjust and repulsive. The companies say profits from the policies can help offset the increased cost of employee benefits and enhance the businesses bottom lines.

Corporate-owned life insurance actually comes in two flavors:

Executive or key person policies that insure the lives of top executives. This coverage has been around for decades and has a clear business purpose, since losing the expertise, knowledge and contacts of top managers can be financially devastating for companies.

Broad-based or janitors policies that insure rank-and-file workers. Here the purpose is basically profit. The life insurance

> proceeds are tax-free. The policies have an investment component that allows companies to earn tax-deferred returns while the employee is still alive. And, of course, companies can take out tax-free loans on the policies. All these gains and income are used to fund operations, pay for executive compensation or boost other benefits.

No one knows how many corporate-owned policies are issued on executives versus rank-and-file workers. Wal-Mart alone had taken out about 350,000 such policies between 1993 and 1996. Nestle USA had policies on 18,000 workers in 2002, The Wall Street Journal reported. Enron had $500 million in policies on workers.

Sales of the policies came to a virtual standstill in September 2003, according to the insurer trade group ACLI, when the Senate Finance Committee approved legislation that would have taxed payouts made to companies if the employee had left more than a year earlier. That indicates that most policies arent being sold to protect companies financially against the loss of key current employees.

Strong insurance industry protests led the powerful committee to reconsider its action. Further work on the issue has been postponed until 2004, and indications are that the senators are softening on the idea of greatly restricting the policies, said Jack Dolan, ACLI spokesman.

Companies insist that janitors policies have a legitimate business function, but the IRS has been cracking down, arguing that many of the arrangements are nothing more than tax shelters. The agency has been particularly harsh on once-popular leveraged policies, in which policy loans were used to pay premiums. In the mid-1990s, the tax agency began disallowing billions of dollars in interest payment deductions the companies had been taking on such loans. Companies efforts to defend their programs have been largely unsuccessful; a U.S. Tax Court judge called Winn-Dixies program a sham, saying it lacked economic substance and business purpose.

The controversy helped convince Walt Disney and Wal-Mart, among others, to drop the policies. Winn-Dixie battled the IRS in court, but the supermarket chain recently lost its final round when the Supreme Court refused to review a lower court decision that backed the IRS.

So far, one company has prevailed against the IRS -- Dow Chemical, which took out the policies on more than 21,000 workers. A U.S. District Court in the Eastern District of Michigan ordered the IRS to return $22.2 million plus interest to the company. The IRS has appealed the ruling.

Survivors lawsuits, meanwhile, typically focus on two issues:

- Whether the companies had an insurable interest in their employees lives.
- Whether the companies were required to get the employees permission for the policies.

Insurable interest is usually a big deal for insurers. They want to make sure whoever is buying life insurance doesnt have an incentive for bumping off the insured. Insurers usually require purchasers have a strong familial or emotional connection to the people being insured, or that they would suffer significant financial losses if the insured people died.

(Its that latter standard that was loosened in the 1980s, making it easier for companies to buy policies for all their employees, not just key executives.)

Most states also have advise and consent laws that technically require companies to get workers permission before buying life insurance on them. But attorney Myers said many businesses circumvent these laws by purchasing the insurance in one of the states that doesnt require notice or consent, including Delaware, Georgia, New Jersey, North Carolina, Pennsylvania and Vermont.

"Executives fly to Atlanta to meet with the insurance company and its brokers, sign some papers, get on their respective corporate jets and fly home, Myers said.

Other companies offered their workers small policies -- typically $5,000 to $10,000 -- as an incentive to allow larger corporate-owned policies to be issued on the workers lives. The small policies can later be canceled, even if the company keeps up the premiums on the other insurance.

Anger about these practices likely will keep the heat on Congress to make some reforms. Its possible that lawmakers will restrict severely companies ability to write the policies on rank-and-file workers. At the very least, companies probably will have to get workers consent before buying any new policies and clearly disclose that the coverage may extend past the time they leave the company, the ACLIs Dolan said.

But he rejected the idea that corporate-owned life insurance was immoral or a company bet against its workers.

Its an important business planning tool, Dolan said. Companies are using it for extremely valid reasons.

Liz Pulliam Weston's column appears every Monday and Thursday, exclusively on MSN Money. She also answers reader questions in the Your Money message board.

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