

Legislative Brief

Group Term Life Insurance Commonly Asked Questions



Many employers provide employees with employer paid group term life insurance benefits and/or allow employees to purchase group term life insurance benefits. This [b_officialname] Legislative Brief will summarize for you the answers to many of the common questions we've received regarding group term life insurance benefits.

Must the cost of employer paid group term life insurance be included in an employee's gross income?

Pursuant to Internal Revenue Code Section 79, premiums paid by the employer for group term life insurance up to \$50,000 are excludable from income. In addition, the employer may deduct the premiums paid as an ordinary and necessary business expense so long as the employer is neither directly nor indirectly the beneficiary under the policy.

May the employer purchase group term life insurance for its employees in excess of \$50,000?

Yes. However, the "cost" of such excess coverage must be included in the employee's gross income. "Cost" as used here does not refer to the premium paid by the employer but to the cost determined under the Uniform Premium Table contained in the IRS regulations. The "cost" of the coverage added to an employee's gross income is commonly referred to as "imputed income."

Example

A 32-year-old employee is covered by an employee benefit plan that provides \$60,000 of employer-paid group-term life insurance. Using Table I, we'll calculate the "cost" to be added to the employee's annual gross income.

Age	Cost of \$1,000 of GTL Per Month	Cost of \$1,000 of GTL for One Year
Under 25	\$0.05	\$0.60
25-29	\$0.06	\$0.72
30-34	\$0.08	\$0.96
35-39	\$0.09	\$1.08
40-44	\$0.10	\$1.20
45-49	\$0.15	\$1.80
50-54	\$0.23	\$2.76
55-59	\$0.43	\$5.16
60-64	\$0.66	\$7.92
65-69	\$1.27	\$15.24
70 and above	\$2.06	\$24.72

<u>Benefit</u>	<u>Annual Cost Per \$1,000</u>
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\$1 - \$50,000	0
\$50,001 - \$60,000	\$.96

<u>Imputed Income</u>	
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\$.96 x 10 (no. of \$1,000 units)	= \$9.60
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*These figures reflect the reduction in rates effective July 1, 1999. The Table I rates were reduced pursuant to IRS regulations. As a result of this reduction, the amount added to an employee's gross income at the end of the year will be less.

Note: Employees will often have imputed income when employee-pay-all optional life plans include a single composite rate that covers the entire cost of the program. In such a case, younger employees would pay a relatively higher rate than the true cost of coverage while older employees pay a relatively lower rate than the true cost of coverage. In this case, older employees could have imputed income. Imputed income could also arise if the plan used fewer age brackets than the IRS table.

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Can employees purchase group term life insurance benefits with pre-tax dollars?

Yes, but only under a Section 125 Cafeteria plan. Employees may purchase, with pre-tax dollars, up to \$50,000 of group term life insurance without having any "cost" of that coverage included in gross income. Note: An employee may not use this exception if the employer has already provided up to \$50,000 employer paid group term life insurance benefits.

May employees purchase supplemental group term life insurance benefits in excess of \$50,000?

Yes, but the employee must include in gross income the "cost" of such excess coverage. As with employer paid group term life insurance in excess of \$50,000, the "cost" is determined by using the Table I rates set forth in IRS regulations.

Example

While the employer does not pay any portion of the premium, it offers its employees an opportunity to purchase group term life insurance benefits. A 39 year-old employee purchases \$150,000 worth of coverage. The employee pays \$2 per month with after tax dollars. Using Table I, we'll calculate the "cost" to be added to the employee's annual gross income.

<u>Contributions Made With Post Tax \$:</u>	
<u>Benefit</u>	<u>Annual Cost Per \$1,000</u>
\$1 - \$50,000	0
\$50,001 - \$150,000	\$1.08
\$1.08 x 100	= <u>\$108.00</u>
- Employee Contribution	<u>\$24.00</u>
Imputed Income	\$84.00

Note: As the Table I rates were recently reduced, in many cases the rates charged by the insurer will be higher than the Table I rates. Thus, in many instances where employee contributions are made with post tax dollars, imputed income will be zero.

May employees purchase with pre-tax supplemental dollars group term life insurance benefits in excess of \$50,000?

While employees that purchase, with pre-tax contributions, group term life insurance coverage of up to \$50,000 realize a tax savings, this is not true when coverage in excess of \$50,000 is purchased.* Employee paid contributions for the portion of group term life insurance in excess of \$50,000 should be paid with post tax dollars.

According to the IRS, when group term life insurance in excess of \$50,000 is purchased with pre-tax employee contributions, imputed income is the Table I cost for the excess coverage.

Example

As stated in the example above, a 39 year-old employee purchases \$150,000 worth of coverage. The employee pays \$2 per month with pre-tax dollars. Using Table I, we'll calculate the "cost" to be added to the employee's annual gross income.

<u>Contributions Made With Post Tax \$:</u>	
<u>Benefit</u>	<u>Annual Cost Per \$1,000</u>
\$1 - \$50,000	0
\$50,001 - \$150,000	\$1.08
\$1.08 x 100	= <u>\$108.00</u>
Employee Pre-Tax Contribution	\$24.00
Imputed Income	\$108.00

*Note: In comparing this example to the post tax example, the employer's tax liability is greater because it must withhold FICA taxes from \$108 versus \$84. In addition, the employee's imputed income is also greater when contributions are made pre-tax.

How can an employer allow its employees to purchase group term life insurance coverage in excess of \$50,000 and avoid the issue of imputed income?

An employer may avoid subjecting the supplemental group term life insurance policy to IRC Section 79 by offering two separate policies.

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The first policy would include the employer paid coverage (i.e., one times the employee's salary). This base policy would continue to be subject to IRC Section 79. The second employee-pay-all policy would allow employees to purchase additional coverage with after-tax dollars. IRC Section 79 applies to group term life insurance that is "carried directly or indirectly" by the employer. The employee-pay-all policy is not "carried directly or indirectly" if the rates are a) at or below the Table I rates, or b) at or above Table I. However, if one employee pays less than and one employee pays more than the Table I rates, this "straddling" of the Table I rates will cause the policy to be treated as a policy "carried directly or indirectly" by the employer. Hence, the employer is responsible for imputing income.

In addition, the premiums charged for the two policies must be determined independently and reserves or experience credits cannot be shifted from one policy to the other. [Priv. Ltr. Rul. 200033011 (May 18, 2000)]

Are the proceeds from an employer paid group term life insurance policy taxable to the beneficiary?

No. Pursuant to IRC Section 101(a)(1), life insurance proceeds are excluded from the beneficiary's gross income. However, this exclusion does not apply if the proceeds of the policy were transferred for valuable consideration.

Are the proceeds from an employer paid group term life insurance policy included in the employee's income for federal tax purposes?

While life insurance proceeds are not included in the employee's income for federal tax purposes, generally the proceeds are included in the employee's estate and subject to federal estate taxes. With proper estate planning and the assistance of a tax consultant, it is often possible to avoid inclusion of life insurance proceeds within the decedent's/employee's estate.

Where an employee has paid the premiums for the group term life insurance policy, the same tax treatment as stated above will apply.

Contact your Progressive Benefit Solutions representative with any questions.

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