NIS National Insurance Services

NIS Guide

# Taxability of Employer-Provided Group Term Life Insurance Benefits

## The 4 Requirements

### Nontaxable Group Term Life Insurance Benefits

Employers can provide their employees with up to $50,000 of group term life insurance coverage on a tax-free basis. To qualify, employer-provided group term life insurance must meet the following 4 requirements:

1. Life insurance must provide a general death benefit that is excludable from the beneficiary's gross income as provided by IRC §101(a)
2. Life insurance must be provided for a group of at least 10 full-time employees (note: small plan exceptions exist)
3. Life insurance must be provided under a policy carried directly or indirectly by the employer
4. Employer must provide each employee an amount of insurance, computed under a formula that precludes the employee's selection of the amount of coverage

## Failure to Satisfy IRC §79 Requirements

If employer-provided life insurance does not meet these four requirements, covered employees will recognize income from this benefit. The amount reported as taxable wages on the employee's Form W-2 is the employer's entire cost of the insurance premiums, net of any employee contributions. This amount is also subject to Social Security and Medicare tax and, if applicable, the additional 0.9% Medicare surtax but is exempt from federal unemployment (FUTA) tax.

## Group Term Life Insurance Coverage in Excess of $50,000

If the four requirements are met, special tax treatment applies. The cost of employer-provided group term life insurance coverage is included in the employee's gross income only to the extent the cost of the policy coverage exceeds the cost of $50,000 of such insurance.

The taxable amount, frequently referred to as imputed income, is reported as compensation on the employee's Form W-2 in boxes 1, 3, and 5 and is subject to Social Security and Medicare tax and, if applicable, the additional 0.9% Medicare surtax. The imputed income is also reported on the employee's Form W-2 in Box 12, Code C. This amount, however, is exempt from federal income tax withholding and FUTA tax. If the employer agrees to pay the employee's share of FICA taxes on the amount of excess coverage, this payment is additional compensation to the employee.

Only one $50,000 exclusion is available to each employee, regardless of the number of employers offering group term life insurance to that employee.

These materials are intended to provide benefit administrators and employers with a general summary of some of the possible tax implications of employer-provided group term life, group voluntary term life, and dependent term life insurance coverage. Please consult your tax advisor for additional guidance.

## Calculating the Amount Includable In Income for Group Term Coverage

The cost of group term life insurance coverage included in the employee's income is not the employer's actual premium cost for the excess coverage. Instead, this amount is imputed using a uniform premium rate schedule provided by the IRS (Table 1). Imputed cost is determined using a cost per $1,000 and the employee's age at December 31 using five year age brackets. The formula for the imputed income calculation is as follows:

[((Total group term coverage - $50,000)/1,000) x Table 1 rate x 12] – total employee after-tax contributions

## IRC §79 Table 1 Rates for Group Term Life Insurance

| Age of Employee at 12/31 | Monthly Cost per $1,000 of Excess Coverage |
|---|---|
| Under 25 | $0.05 |
| 25 to 29 | $0.06 |
| 30 to 34 | $0.08 |
| 35 to 39 | $0.09 |
| 40 to 44 | $0.10 |
| 45 to 49 | $0.15 |
| 50 to 54 | $0.23 |
| 55 to 59 | $0.43 |
| 60 to 64 | $0.66 |
| 65 to 69 | $1.27 |
| 70 and Over | $2.06 |

## Illustration Using Table 1

In the current year, the employer provided a $100,000 group term life insurance policy for a current employee. The employer's group term life insurance plan meets the 4 Requirements. The employee is 46 years old as of December 31 of the current year. Using Table 1, the cost of $1,000 of insurance for one month for a 46-year-old individual is $0.15. Since the face amount of the insurance coverage remains the same throughout the year, the employer calculates the taxable cost of the excess group term coverage on an annual basis. Assuming the employee contributes $5.00 per month ($60.00 annually) on an after-tax basis toward the cost of this policy, the taxable cost of the employee's excess group term coverage is as follows:

| | | |
|---|---|---|
| Amount of coverage | 1 | $100,000 |
| Less: nontaxable coverage | 2 | ($50,000) |
| Excess coverage (line 1 – line 2) | 3 | $50,000 |
| Line 3 rounded to the nearest tenth of $1,000 | 4 | 50 |
| Cost per $1,000 of coverage for one month (from Table 1) | 5 | $0.15 |
| Monthly cost of excess coverage (line 4 x line 5) | 6 | $7.50 |
| Number of months the employee had coverage during the year | 7 | 12 |
| Total cost of excess coverage (line 6 x line 7) | 8 | $90 |
| Less: after-tax amount employee paid for coverage | 9 | ($60) |
| Cost of excess group term coverage includable in income | 10 | $30 |

If the amount of coverage changes during the year, the above formula would need to be modified to calculate imputed income for each period where coverage differs.

## Voluntary or Supplemental Term Life Insurance Coverage

If a group term life insurance plan is sponsored by an employer but all premiums are paid by the employees, it is not subject to the imputed income rules under IRC §79—unless the plan is deemed to be carried by the employer. A policy is considered carried by the employer if:

1. The employer pays any part of the cost of the life insurance, either directly or through another person, or
2. The employer (or two or more employers) has employees pay for the cost of the life insurance, but charges at least one employee less than the cost of the life insurance (as determined under Table 1) and charges at least one other employee more than the cost of his life insurance as per Table 1.

Group term life insurance is considered to be carried by an employer where part of the premium for one employee actually comes from excess contributions of other employees. This can happen, for example, when an employer charges each employee a flat amount per $1,000 of insurance coverage per year. Such payment arrangements may cover more than the cost of insurance on the lives of younger employees but fall short of the cost of coverage for employees in the older age brackets. This is frequently referred to as straddling. Under such a plan, employees who pay less than the Table 1 cost of group term life insurance must include in income a portion of the cost of the insurance. The exclusion of the first $50,000 continues to apply if the employee is not offered employer paid basic life insurance. If the employee is offered employer-paid basic life insurance but the amount of coverage is less than $50,000 then the difference between $50,000 and the amount offered can be excluded from the imputed income calculation.

## Illustration of Calculation of Imputed Income for Voluntary Term Life Insurance Coverage Plans

Employer sponsors a group term life insurance plan under which participating employees pay all the premiums. Lauren, 52 years old, and Jay, 60 years old, each buy $500,000 of group term life insurance under the plan. Lauren and Jay each pay premiums of $0.50 a month per $1,000 of insurance. Since Lauren pays more than the Table 1 amount for her age bracket ($0.23) and Jay pays less than the Table 1 amount for his age bracket ($0.66), the plan is treated as carried by employer. Thus, Jay must include the following amount in income from the group term life insurance provided under the plan:

| | | |
|---|---|---|
| Amount of coverage | 1 | $500,000 |
| Less: nontaxable coverage | 2 | ($50,000) |
| Excess coverage (line 1 – line 2) | 3 | $450,000 |
| Line 3 rounded to the nearest tenth of $1,000 | 4 | 450 |
| Cost per $1,000 of coverage for one month (from Table 1) | 5 | $0.66 |
| Monthly cost of excess coverage (line 4 x line 5) | 6 | $297 |
| Number of months the employee had coverage during the year | 7 | 12 |
| Total cost of excess coverage (line 6 x line 7) | 8 | $3,564 |
| Less: after-tax amount employee paid for coverage | 9 | ($3,000) |
| Cost of excess group term coverage includable in income | 10 | $564 |

Lauren does not have to include any portion of the cost of her insurance in income since she paid more than the Table 1 cost of her insurance.

## Employer-Provided Dependent and Spousal Term Life Insurance Coverage

The cost of employer-provided group term life insurance coverage on the life of an employee's spouse or dependent does not qualify for Section 79 income exclusion. However, if the face amount of employer-provided group term life insurance on an employee's spouse or dependent does not exceed $2,000 each, the insurance is deemed to be a de minimis nontaxable fringe benefit and is not subject to imputed income.

When determining whether employer-provided dependent group term life insurance with a higher face amount is de minimis, only the excess (if any) of the cost of such insurance (calculated using Table 1 rates) over the amount paid for by the employee on an after-tax basis is considered. Generally, employer-provided dependent life insurance is not taxable to the employee to the extent the employee pays for the insurance with after-tax dollars.

## Avoiding Imputed Income

Employers can avoid imputed income issues on supplemental/voluntary term life Insurance plans by ensuring that:

1. All rates charged to employees are:
   a. Equal to or less than the Table 1 rates; or
   b. Equal to the Table 1 rates; or
   c. Equal to or greater than the Table 1 rates;
2. Premiums are paid with after-tax deductions;
3. If Basic Life is provided on the same policy, the insurer properly allocates premiums between the basic and supplemental/voluntary life policies; and
4. Coverage is nondiscriminatory.

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## You may also be interested in the following resources:

- Guide to Insurance Committees
- Guide to Restructuring Retiree Benefits
- Health Insurance Rx: 5 Remedies to Slow Escalating Costs Now

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