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COMPLIANCE ALERT
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Code Section 79 & Group Term Life Insurance

This bulletin provides general information regarding the tax treatment of group term life insurance. It is not an exhaustive analysis and should not be relied upon as legal or tax advice.

GROUP TERM LIFE INSURANCE

Code Section 79 applies to group term life insurance. Group term life insurance is defined as:

- Providing a general death benefit excludable from gross income under IRC 101(a),
- To a group of employees,
- Under an insurance policy carried directly or indirectly by the employer, and
- The amount of insurance provided to each employee must be computed under a formula that precludes individual selection of such amounts. [1]

An employer may provide up to $50,000 in group term life insurance to an employee tax-free. The value of life insurance coverage furnished by the employer in excess of $50,000 is imputed as income to the employee. This value is determined based on the IRS Table 1 rates.

IRS TABLE 1 RATES

The regulations provide Table I to determine the value of group term life insurance for purposes of calculating imputed income.

TABLE I
Uniform Premiums for $1,000 of Group-Term Life Insurance Protection
26 CFR 1.79-3(d)(2)

5-Year Age Bracket *Based on attained age at the end of the taxable year*	Cost Per $1,000 of Protection for One Month
Under 25	$0.05
25-29	$0.06
30-34	$0.08

[1] *Special rule for groups with fewer than 10 full-time employees***.** The definition of group term life insurance also requires at least 10 full-time employees are provided with the benefit. However, there are exceptions to the 10 full-time employee rule, including when all full-time employees of the employer are provided the insurance or, if evidence of insurability is required, all full-time employees providing such evidence. *See IRS Publication 15-B and 26 CFR 1.79-1(c) for more information on these requirements and the exceptions.*

35-39	$0.09
40-44	$0.10
45-49	$0.15
50-54	$0.23
55-59	$0.43
60-64	$0.66
65-70	$1.27
70 and above	$2.06

Using the Table 1 rates, monthly imputed income is calculated based on the benefit amount in excess of $50,000 (determined in thousandths) multiplied by the IRS Table 1 rate based on the employee's age at the end of the taxable (calendar) year.

EMPLOYEE CONTRIBUTIONS TO GROUP TERM LIFE INSURANCE

Post-Tax
Employees paying for group term life insurance with post-tax dollars may reduce the total amount of imputed income by the post-tax contributions.

Pre-Tax under a Section 125 Plan
If employees elect to pay group term life insurance through a cafeteria plan, imputed income is calculated using the Table 1 rates for coverage in excess of $50,000.

NONDISCRIMINATION REQUIREMENTS

A group term life insurance plan that favors key employees as to eligibility or benefits may be a discriminatory arrangement. In determining whether the plan is discriminatory there are two tests that the plan must pass, the *Eligibility Test* and the *Benefits Test*.

Key Employee
For 2009 and 2010, a "key employee" is defined as an employee who at any time during the current plan year is:

- An officer of the employer having annual compensation greater than $160,000;[2]
- A 5% owner of the employer; or
- A 1% owner of the employer having annual compensation of more than $150,000.

Eligibility Test
Group term life insurance plans are discriminatory if the plan favors key employees with respect to eligibility. A plan is considered nondiscriminatory with respect to eligibility if:

1. It benefits at least 70% of all employees;
2. At least 85% of the participants are not key employees;
3. The plan benefits a class of employees found by the Secretary to be nondiscriminatory (*nondiscriminatory classification test)*; or
4. If offered under a Section 125 plan, the nondiscrimination requirements under Section 125 are satisfied.

[2] Compensation threshold adjusted annually. For 2009 plan limitation adjustments, see *IR-2008-118*. For 2010 plan limitation adjustments, see *IR-2009-94*, http://www.irs.gov/newsroom/article/0,,id=214321,00.html.

Benefits Test
Group term life insurance plans are discriminatory if the benefits available to all key employees are not available to all other participants. There are certain safe harbors available, including a plan that provides a fixed amount of insurance for all employees or is designed to bear a uniform relationship to total compensation.[3]

For example, a plan that covers all eligible employees at "1x annual salary" will not be discriminatory as to benefits even though key employees have higher salaries than non-key employees. However, a plan that provides a benefit of "1x salary" to all non-key employees and "2x salary" to key employees may be discriminatory.

Discriminatory Plan
Key employees benefiting under a discriminatory arrangement lose the $50,000 exemption and imputed income is calculated based on the greater of the Table 1 cost of coverage or the actual cost of coverage.

This rule only applies to key employees benefiting under a discriminatory arrangement. Non-key employees retain the $50,000 exemption.

VOLUNTARY LIFE INSURANCE PLANS

When calculating imputed income, it is important to review any employer-provided coverage under a voluntary life insurance program. In some circumstances, voluntary life insurance may be considered group term life insurance; therefore, it could be subject to imputed income rules for amounts in excess of $50,000.[4]

Voluntary group term life insurance benefits are not included as imputed income to the employee when the coverage meets the following three requirements:

1. The premium is paid entirely by the employee (outside of a Section 125 plan),
2. The costs and coverage can be separated from an employer-paid policy, and
3. The policy is not carried by the employer (directly or indirectly).
    - Straddle Test: If the rates for voluntary group term life insurance "straddle" the IRS Table 1 rates (meaning the plan's rates are both above and below the Table) the policy is deemed to be "carried by the employer", therefore imputed income will apply. If the rates do not "straddle" the Table, then the policy is not "carried by the employer."

SPOUSE & DEPENDENT LIFE INSURANCE COVERAGE

The $50,000 exclusion from income only applies to group term life insurance provided by the employer to the employee. If the employer purchases life insurance on behalf of the employee's spouse or dependent, the $50,000 exemption under Section 79 does not apply. Generally the fair market value of such coverage is treated as taxable income to the employee.[5] However, Code Section 132 provides a limited exception when the face

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[3] *Temp. Treas. Reg 1.79-4T; Q/A-9;* an additional safe harbor may be available when, under the facts and circumstances, the classification of different groups of employees under a life insurance plan passes the requirements of the eligibility test illustrated above. Generally, classifications with many key employees and few non-key employees will have difficulty passing this test.
[4] Not all voluntary life insurance policies will satisfy the Code Section 79 definition of a group term life insurance plan. It is important to check with the applicable carrier regarding the status of the voluntary plan.
[5] *26 CFR 1.61-21(b)(1)*

value of the life insurance policy is $2,000 or less. In such instances, the value of the coverage may be excluded from the employee's income as a de minimis fringe benefit.

Employees purchasing additional life insurance on a spouse or dependent must do so on an after-tax basis. Assuming the employee pays the fair market value for coverage, no amount is included as income to the employee.[6] It is important to note that spouse and dependent life insurance are nonqualified benefits and may not be offered under a Section 125 cafeteria plan (i.e. the employee may not purchase spouse or dependent life insurance on a pre-tax basis). Review your plan documents and summary plan description to ensure such coverage is not provided under the cafeteria plan.

Additional information on group term life insurance can be found at:

- IRS Publication 15-B "Employer's Tax Guide to Fringe Benefits" page 10 http://www.irs.gov/pub/irs-pdf/p15b.pdf
- IRC Section 79;
- Treas. Reg. § 1.179-1 – General Rules on Group Term Life Insurance; and
- Treas. Reg. § 1.179-4T – Q&A on Nondiscrimination Requirements.

If you have any questions or if we may be of further assistance, please contact your client service team at 206-441-6300.

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[6] *26 CFR 1.61-21(b)(1)(ii)*