EMPLOYEE BENEFITS

# Group-Term Life Insurance Guide

OCTOBER 2023

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## What Is Group-Term Life Insurance?

Group-term Life (GTL) insurance plans are a popular benefit provided or offered by a vast majority of employers[1] to their full-time employees. GTL provides income and asset protection to a covered employee's survivors in the event of the death of the employee during the years the insured is actively employed.

Depending on the plan, additional benefits such as accidental death and dismemberment, spouse and dependent life insurance coverage, accelerated death benefits and disability premium waivers may also be included provisions under a GTL policy. Often, group-term life insurance carriers will also provide additional value-added benefits to covered individuals for no additional cost. These additional benefits are discussed later in this guide.

There are many advantages to employers who offer or provide group-term life insurance to employees. For example:

- Spouse and dependent life insurance coverage may also be available to covered employees under the GTL plan.
- The cost for the insurance is generally affordable due to the spread of risk over the entire insured population, based on the group's demographics and carrier book-of-business blended with plan experience.
- Premiums can be paid by the employer under a non-contributory arrangement (referred to as "basic life" insurance), employers and employees can share in the cost or the plan can be totally voluntary (premiums are fully paid by employees). Employees can be offered an option to purchase additional coverage to supplement an employer-paid life insurance benefit. Pooling of risk generally means that the cost of coverage is less expensive than premiums paid for individual term life insurance policies.
- Often, coverage is provided on a guaranteed issue basis, which means there is no medical underwriting if individuals enroll in coverage when they are first eligible. However, if benefits elected by an employee exceed the guaranteed limits, coverage is subject to evidence of insurability (EOI) and underwriter approval. Until the underwriting decision is received, employers will want to be cautious about deducting premiums that exceed the premiums applicable to the guaranteed issue limit from employees' paychecks to avoid any potential liability for claims if EOI (showing the individual was insurable at the time of application) has not been received by the insurer.[2]
- Employers can deduct the amounts they pay for GTL from corporate taxes, and benefits paid to survivors are not taxable. Special rules apply with respect to the taxability of employer-provided life insurance for covered employees. See the section titled "Taxation of Employer-Provided Group Term Life Insurance" for specific details.

*[1] Per the International Foundation of Employee Benefit Plans (IFEBP) 2022 Employee Benefits Survey, 93.8% of corporations and 96.1% of public employers offer group-term life to salaried employees. For hourly employees, 83.4% of private corporations and 76.5% of public employers offer group-term life insurance.*

*[2] In April 2023, the DOL reached a settlement with Prudential whereby Prudential agreed to voluntarily reprocess claims and pay death benefits going back to 2019 that were previously denied for failure to submit EOI when premiums were paid for one year or longer. In addition, the settlement prohibits Prudential from denying future claims when the employee has paid premiums for a period of more than three months (in cases where premiums were paid for less than three months prior to the death, Prudential agreed to return the premium overpayment to the beneficiary with an explanation of why the excess claim was denied). Under the settlement, the insurer must "work with the employer and the employee or eligible dependent to affect the proper submission" of EOI. See the DOL News Release regarding the settlement for more details. The DOL states in the News Release that they "would urge all insurers to examine their practices to ensure that they aren't engaged in similar conduct." Furthermore, the settlement noted that if employers sponsoring life insurance plans collect premiums from employees "for the supplemental portion of the insurance without first confirming that [the insurance carrier] has approved that employee's or eligible dependent's EOI, the [employer] may be liable to the beneficiaries of said employee or their eligible dependent."*

## How Much Group-Term Life Coverage Is Generally Provided?

**Basic Life Insurance:**

Employers can determine the amount of employee basic life coverage based on a multiple of earnings (e.g., one to five times covered annual earnings) or a flat dollar benefit.

- When the scheduled benefit is a multiple of earnings, generally, coverage is capped at a specific dollar level for employees whose benefit would otherwise exceed that amount.
  - For example, an employer might adopt a basic life schedule of 2X annual earnings capped at $200,000. An employee earning more than $100,000 would be covered at the $200,000 maximum.
  - Generally, the basic life insurance coverage is offered on a guaranteed issue basis.
- ADEA-permitted age reductions[3] may apply. For instance, a policy might reduce a benefit to 65% of the original benefit at age 65, 50% at age 70 and 35% at age 75 or older.
  - Example: The employer purchases basic life insurance coverage of $200,000 for an employee. When the employee reaches age 65, his coverage will reduce to $130,000. At age 70, his benefit is $100,000. At age 75 or older, the employee receives $35,000 in life insurance coverage.
- Typically, the scheduled benefit is rounded to the nearest or next higher increment of $1,000.
  - Example: An employer provides a benefit of 1X annual salary. Their employee earns $76,232 in annual base earnings. The employee receives coverage of $76,000 if the schedule rounds to the nearest $1,000 (or $77,000 if the scheduled benefit is rounded to the next higher $1,000).

**Employee Voluntary or Supplemental Insurance:**

Under these types of policies, eligible employees can generally purchase coverage in increments of $10,000, subject to a specified maximum. Coverage up to a lower limit may be offered on a guaranteed issue basis.

- Example: Employer A offers all eligible full-time employees an opportunity to purchase up to $500,000 in group-term life insurance coverage, in units of $10,000. The carrier allows employees to elect up to $200,000 in coverage without providing evidence of insurability if they enroll when they are first eligible for the coverage. Amounts elected that exceed $200,000, up to the $500,000 limit, are subject to health history underwriting.
- As is the case with employee basic life insurance coverage, age reductions can apply to employee voluntary of supplemental life coverage.

**Spouse and Dependent Life Insurance:**

Employers can purchase basic spouse and dependent life insurance on an employer-paid basis or offer the employee the opportunity to purchase coverage. Dependent life insurance provides a benefit payable to the employee in the event of the death of the employee's spouse or dependents.

- ***Spouse Term Life Coverage:*** Can be offered as either a flat dollar amount, in units of $5,000 or $10,000 or as a percentage of the group-term life insurance coverage in force on the employee's life.
  - Typically, the amount of coverage available for a spouse may not exceed a percentage of the term life insurance coverage in effect on the employee's life (50% is common).
  - Generally, spouse coverage is only issued up to a limiting age (e.g., age 70), and up to that age, benefits are reduced when age reductions apply to the employee's coverage. Coverage may end at a specified age, even if the employee remains covered by the plan.
- ***Dependent Term Life:*** Coverage for dependents of an insured employee is generally available under a schedule that either provides flat dollar benefit or incremental units of coverage applicable to all eligible dependents.
  - Example 1 – Flat dollar benefit: Employer provides all employees who have dependents a flat basic dependent life benefit of $2,500, paid by the employer.
  - Example 2 – Unit basis benefit: Employer offers employees voluntary dependent life coverage in $2,000 units, up to a maximum of $10,000. All dependents are covered by one premium per unit of coverage, regardless of the number of dependents covered on the policy.

[3] *The Age Discrimination in Employment Act (ADEA) prohibits employers from discrimination against employees due to age. However, because the employee's age bears a direct effect on claims and premium costs, age reductions to life benefits "will not violate the Act (even if reductions start before age 65), provided that the reduction for an employee of a particular age is no greater than is justified by the increased cost of coverage for that employee's specific age bracket encompassing no more than five years. It should be noted that a total denial of life insurance, on the basis of age, would not be justified under a benefit-by-benefit analysis. However, it is not unlawful for life insurance coverage to cease upon separation from service." (CFR Title 29 § 1625.10(7)(f)(i)).*

## Accidental Death & Dismemberment (AD&D) Coverage

Frequently, AD&D coverage is included as a scheduled benefit under the GTL policy, or it can be added as an optional rider for additional premium. AD&D coverage provides a benefit in the event there is a loss of life, limb, sight, hearing, speech or use of limbs (paralysis) caused by a covered accident. Some AD&D riders also include coverage for accident-caused disabilities. Typically, the AD&D benefit paid to the covered individual's survivors for accidental death is equal to the life insurance benefit. This is also referred to as the "principal sum." Death benefits paid to a covered individual's survivors are non-taxable.

Example: Employer provides all eligible employees with $100,000 GTL policy that includes AD&D coverage. If the death of a covered individual is on account of an accident, the benefit payable would be $200,000 ($100,000 GTL plus $100,000 in AD&D coverage).

Benefits for other covered losses are based on a percentage of the principal sum, depending on the severity of the condition caused by the accident. For example, loss of hearing might provide a benefit of 25% of the principal sum, while quadriplegia might have a benefit equal to the principal sum. Accidental dismemberment or disability benefits may be taxable to the covered individual[4], depending upon whether premiums paid were taxable.

[4] *See IRS Publication 525 for the definition of Taxable and Non-Taxable Income.*

## Beneficiary Designations

GTL participants may designate one or more beneficiaries who will receive benefits if the insured passes away while covered by the plan. The beneficiaries who stand in the first position are called "primary beneficiaries" and can be one or more of the following who can be given a specific percentage of the benefit (up to a total of 100%):

- One or more named persons
- A trust or estate
- A nonprofit/charitable organization
- Another entity

The insured may also name one or more contingent (or secondary) beneficiaries if the designated primary beneficiary/beneficiaries are no longer living at the time the benefit is payable.

If there is no valid beneficiary designation on file at the time of the insured's death, there is an ordering rule applicable to the benefits, which is typically regulated by state statutes and is outlined in the policy and certificate of coverage. A typical order of beneficiary determination might be similar to the following example:

- Spouse
- Child(ren)
- Parents
- Siblings
- Estate of the insured

## Accelerated Death Benefits

Many insurers offer GTL policies that include an Accelerated Death Benefit (ADB) option. This provision allows an insured to receive a portion of the death benefit while still living if the individual is diagnosed with a terminal illness that is expected to result in death (typically within one year). When death later occurs, the ADB payment is subtracted from the net amount paid to the covered person's beneficiary.

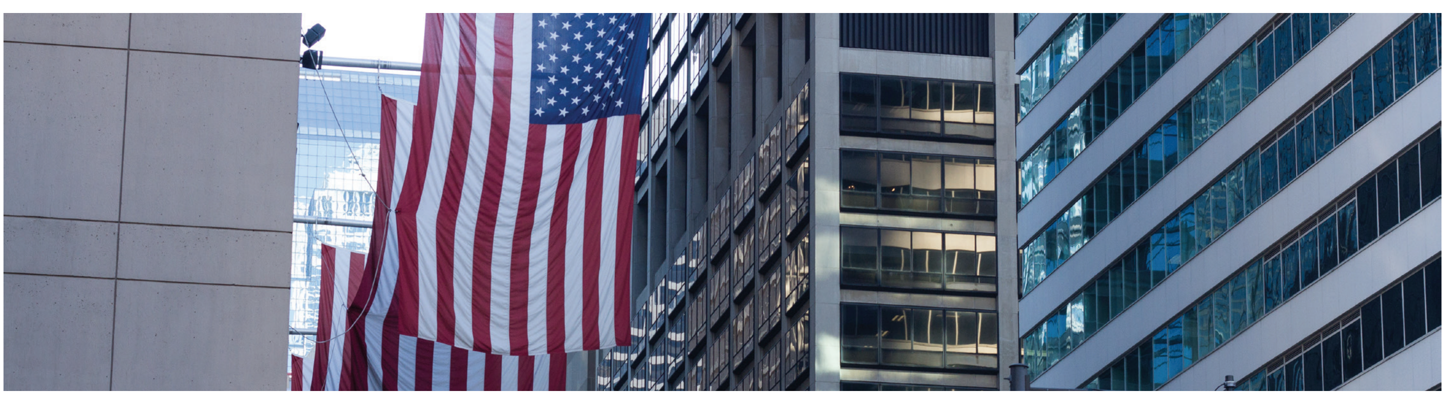
## Disability Waiver of Premium, Portability, Continuation and Conversion

Coverage under a GTL policy typically remains in force while the employee is actively at work in an eligible position. Unless an extension provision applies, coverage will end on the first day the employee is no longer in employment with the plan sponsor. To address this loss of coverage, there are a variety of options that allow for an extension of coverage or conversion of lost GTL to an individual permanent policy. These include:

**Disability Extensions with Waiver of Premium:** When a covered insured is no longer actively at work on account of a total disability, many GTL policies include a Waiver of Premium provision that allows for an extension of coverage without future premium payment. Under this provision, individuals who have been covered by the plan for a minimum period (generally, one year) and who have not reached a specified age (e.g., 60 or 65) at the time of disability may be able to keep their GTL coverage in force. Total disability is generally defined as the inability to perform the material duties of any gainful occupation. There is normally a waiting period of six to nine months before the waiver of premium provision becomes effective – during this waiting period, premium payments must continue. There is typically a deadline (e.g., 12 months) by which application for the waiver of premium must be made, although if the same carrier also provides coverage for long-term disability, the claims process for the two programs may be integrated, with approval of the life waiver occurring automatically once the requirements have been satisfied. Coverage under the GTL policy is extended to a specified age (extensions to age 65 and Social Security Normal Retirement Age are common).

**Portability:** Depending on the GTL policy, former employees whose GTL coverage would otherwise end when they are no longer employed by the plan sponsor may be able to keep their same amount of GTL coverage at group monthly rates[5] for a period of time under a portability feature, provided they elect this option timely (see the terms of the master group policy and certificate) and pay the monthly premiums when they are due. Ported coverage typically ends when the insured becomes covered by another group-term life policy, when premium payments are not made when they are due or on the insured reaches an age specified in the contract.

**Conversion:** Although specifics may vary from state to state, group-term life policies are required in most states to offer individuals who have lost eligibility for coverage under employer-sponsored plans the option to convert up to the coverage they have lost to an individual policy without providing proof of good health. The converted coverage is typically offered in the form of permanent insurance, such as a whole life policy. Premiums are based on the age of the insured at the time the conversion option is exercised and will remain level for as long as the converted policy remains in effect unless the premiums change for all individuals in the covered class. The conversion must generally be elected within 30 days after loss of group coverage.



*[5] While ordinarily the group monthly rates for ported coverage are the same rates that are charged to active employees of the former employer, some insurers' portability option premiums may differ, based on rates filed with the state insurance department. Rates may increase as insureds age. Check the master policy and certificate for details on portability.*

**Continuation (Applicable in MN only)[6]:** Under Minnesota insurance law, insured employees who lose eligibility for group-term life coverage provided by the employer as a result of voluntary or involuntary termination of employment or layoff (including a reduction in hours) must be offered an opportunity to continue group-term life insurance (including basic, voluntary and supplemental coverage) upon loss of coverage for up to 18 months unless the coverage is portable at the same rate and under the same terms as apply to the group policy for active employees. Premium payment is required during the continuation period and can be up to 102% of the billed premium.

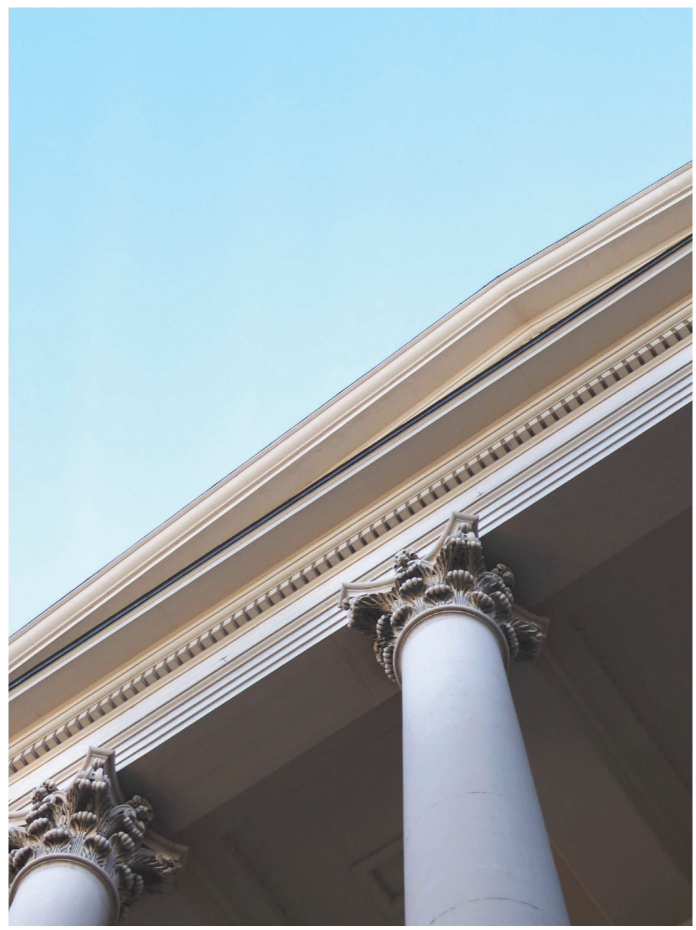
- Depending on the terms of the policy issued by the life insurer, this state continuation provision may be applied only to employees who reside in the state of MN or to all covered employees on a uniform basis.
- The Minnesota continuation provision is not applicable to a policy issued and renewed in another state when no greater than 25% of the total insured population are Minnesota residents, and of that 25%, no more than 25 employees covered by the group plan reside in the state. The continuation requirement applies only to the term life portion of the program, not to other benefits that may be included, such as coverage for accidental death and dismemberment.

**ERISA Preemption:** ERISA generally preempts state laws that impose specific requirements on the employer who sponsors the benefit plan. However, state laws may regulate insurance companies and the policies they offer to ERISA plans. State statutes that regulate insurance (rather than the employer) would be enforceable, even when the coverage is provided to employees under an ERISA plan. For example, state life insurance statutes that require insurers to include a conversion (or continuation) option at the time coverage is lost are enforceable against the insurer. The state law likely cannot, however, require the plan sponsor to notify participants of their conversion/continuation rights because of ERISA preemption.[7] However, if the plan sponsor and carrier have contractually agreed that the plan sponsor must notify participants of those rights, or the terms of the policy require the plan sponsor to do so, the contractual terms might be enforceable even for an ERISA plan.

## Other Benefits

In addition to the coverage described above, group-term life insurance and/or AD&D policies often include benefits for other value-added services. Examples of such items that may be available to covered employees or their beneficiaries include access to:

- Employee assistance benefits[8], which may include referral services and face-to-face, telephonic or virtual visits with a professional mental health or substance abuse counselor.
- Travel assistance, such as travel medical assistance, evacuation, repatriation of remains and other benefits while the insured is traveling away from home.
- Will preparation services.
- Financial counseling for beneficiaries.
- Discounts on specific product



[6] See MN Stat. 61A.092 – MN Stat. 61A.093.
[7] DOL Advisory Opinihon 96-03A.
[8] Although EAP benefits may be provided by the life insurance carrier, to the extent they provide coverage for health care services, they would constitute an employer-sponsored health plan. For more information, refer to Employee Assistance Programs (EAPs) Compliance Considerations for Employers.

## ERISA and Group-Term Life Insurance Plans

ERISA applies to health and welfare benefit programs sponsored by private sector employers, including publicly traded companies and nonprofit organizations. Plans sponsored by churches and governmental entities are not subject to ERISA.[9]

As previously addressed, ERISA generally preempts state laws that require the employer/plan sponsor to perform certain actions with respect to the employee benefit plan unless the plan or issuer otherwise assign responsibilities to the employer.[10]

Group-term life plans are subject to ERISA[11] when they are sponsored by an employer that is subject to ERISA. ERISA imposes certain disclosure and reporting requirements, including the following:

- The plan sponsor must adopt a written plan document that describes the terms of the plan, such as the benefits provided, eligibility requirements and claims provisions. Under ERISA, the plan administrator (typically the plan sponsor) is obligated to administer the plan in accordance with the plan document.
- A Summary Plan Description (SPD) must be provided to all plan participants. The SPD is a summary of the terms outlined in the plan document that is written in language that is intended to be understood by all participants and beneficiaries. It describes the terms of the plan and the plan sponsor's and participants' rights and obligations under ERISA.
- Annual reporting (Form 5500) is generally required. Unless an extension applies, the 5500 is required to be filed by the last day of the seventh month following the end of the plan year. However, there is a small employer exception from the Form 5500 filing requirement for fully insured plans when there are fewer than 100 participants on the first day of the plan year.
- When Form 5500 is required, a Summary Annual Report (SAR) must be provided to all plan participants covered during the applicable reporting year. The SAR summarizes the information reflected on Form 5500 and the rights of participants to view or obtain copies of the full annual report. The SAR is due two months after the Form 5500 filing deadline.

## Taxation of Employer-Provided Group Term Life Insurance Coverage

Under IRC Code § 79, the value of up to $50,000 of group-term life insurance coverage is generally excludable from an employee's income. This exclusion from income of the first $50,000 in life insurance coverage is available for non-discriminatory employer-provided group-term life coverage. The entire value of the benefit is taxable for certain key employees when the plan design is discriminatory.

[9] Plans sponsored by governmental employers, including federal or state governments or political subdivisions of a state (e.g., counties, municipalities, public school districts) that benefit employees are not subject to ERISA. A welfare plan established by a church, or an association or convention of churches, is also generally exempt from ERISA (in some cases, however, the plan sponsor may make an election to become subject to ERISA). However, some non-ministerial businesses operated by churches may be subject to ERISA.

[10] See "Disability Waiver of Premium, Portability, Continuation and Conversion" section of this guide.

[11] An ERISA "employee welfare plan" is defined as: "any plan, fund, or program established or maintained by an employer or an employee organization or both for the purpose of providing participants and beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day .care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 302(c) of the Labor Management Relations Act, 1947 [29 USC §186(c)] (other than pensions on retirement or death, and insurance to provide such pensions)." (ERISA §3 [29 USC §1002] Definitions.

## What Qualifies as Group-Term Life Insurance?

Life insurance qualifies as group-term life insurance for purposes of the IRC Code § 79 tax exclusion only if it meets the following requirements[12]:

- Coverage may not be "permanent"[13];
- The GTL policy provides a non-taxable death benefit;
- The coverage is provided to a group of at least ten (10) full-time employees[14];
- It provides an amount of insurance to each covered employee that is computed under a formula that precludes individual selection (however, benefits and eligibility can vary based on reasonable classifications (e.g., salaried vs. hourly, union vs. non-union, management vs. staff, full-time vs. part-time, active employees vs. retirees or other employment-related factors)); and
- It is carried directly or indirectly by the employer. A policy is considered carried directly or indirectly (i.e., provided) by the employer if the policy premium is either:
  - » Paid in part (contributory) or completely (non-contributory) by the employer; or
  - » Paid for by the employee where the employer arranges for the payment of the cost and the carrier charges at least one employee more and at least one employee less than the rates in Table 2-2 of IRS Publication 15-B (referenced herein as the "Table 2-2 rates").[15] When this occurs, it is referred to as "straddling" the uniform table rates.

### Age Bracket Cost per $1,000

| | |
|---|---|
| Under 25 | $ .05 |
| 25-29 | $ .06 |
| 30-34 | $ .08 |
| 35-39 | $ .09 |
| 40-44 | $ .10 |
| 45-49 | $ .15 |
| 50-54 | $ .23 |
| 55-59 | $ .43 |
| 60-64 | $ .66 |
| 65-69 | $1.27 |
| 70 and above | $2.06 |

Uniform (Table 2-2) Rates - Pub. 15 B Cost Per $1,000 of Protection for 1 Month

In some cases, supplemental coverage purchased by employees on an after-tax basis will not be carried directly or indirectly by the employer and will not be subject to the following taxation rules. For that to be the case, the employer can and must elect to treat the supplemental coverage as being provided under a separate policy from employer-paid coverage (assuming they would normally be deemed to be provided under a single policy because they are issued by the same insurance carrier or its affiliate), and the rates for the supplement coverage must not "straddle" the Table 2-2 rates. An employer may elect to treat the policies as separate if the premiums for each policy are "properly allocated" between the policies (e.g., the carrier separately and independently determines the premiums and accounts for the finances for each policy).

References to group-term life insurance (GTL) below refer only to policies that satisfy the preceding requirements and do not include voluntary life insurance benefits not carried by the employer, nor do they include permanent benefits (i.e., whole or universal life policies, which are not subject to this rule) or accidental death and dismemberment benefits.

*[12] See Treas. Reg. §§ 1.79-0 and 1.79-1 for additional information.*
*[13] Permanent protection contains a cash value accumulation and generally cannot be cancelled during the coverage term. Premiums are determined based on the age of the insured at the time the policy is issued and will remain unchanged for the duration of the coverage (generally, the coverage remains in effect as long as premiums are paid). Examples of permanent coverage include whole or universal life. Term life coverage generally ends when the individual is no longer actively employed, but generally may be converted to a permanent policy at the time coverage ends. See "Continuation, Portability and Conversion," later in this document.*
*[14] An exception to the 10-employee rule may apply if evidence of insurability is limited to completion of a health history questionnaire (i.e., approval does not require a physical examination) and all full-time employees who provide acceptable evidence of insurability are covered by the GTL plan*
*[15] The Table 2-2 rates are taken from Table I in the Code § 79 regulations issued by the IRS and are also known as "Table I rates."*

## Imputing Income to Employees for Non-Discriminatory Plans

Many employers make available group-term life insurance to their employees that exceeds a $50,000 death benefit. In many cases, depending on who pays for it, the value of the additional coverage must be included in the employee's gross income. "Value," as used here, does not refer to the premium paid by the employer or employee but to the cost for the coverage as determined using the Table 2-2 rates. The taxable value of the group-term life coverage added to an employee's gross income is referred to as "imputed income." This imputed income is subject to income tax, but it is not subject to mandatory income tax withholding. The imputed income is, however, subject to FICA withholding.

The Proposed Cafeteria Plan Regulations issued in August of 2007 confirmed that, in compliance with IRC Code § 79, employers need to impute the value of GTL coverage in excess of the $50,000 whether the premiums are paid by the employer or the employee. GTL coverage for this purpose includes both basic employer-paid coverage and, as discussed above, any voluntary/ supplemental GTL coverage purchased by the employee if premiums straddle the Table 2-2 rates.

The Proposed Regulations clarified that flex credits/dollars available under a cafeteria plan can be used to purchase GTL but that if these flex credits/dollars are pre-tax and the death benefit under such policy coverage exceeds $50,000, the value of that excess coverage must be imputed as taxable income to the employee. Additional IRS guidance on how to apply the calculation of the imputed value is described in IRS Publication 15-B: Employer's Tax Guide to Fringe Benefits and briefly in the Proposed Cafeteria Plan Regulations.

In general, the employer must impute the total policy amount of all GTL insurance coverage received by an employee (employer-paid GTL insurance in addition to any employee-purchased life insurance coverage that qualifies as GTL insurance). The employer then deducts the statutory non-taxable amount of $50,000 from the total amount of the employee's GTL insurance coverage to determine the amount of excess coverage. The monthly value of that excess coverage is determined by multiplying the volume of excess GTL insurance coverage by the applicable Table 2-2 rate.

The volume is the number of $1,000 increments (e.g., a policy of $10,000 equals ten units of volume). The rate is the cost per unit based on the individual's age. Table 2-2 rates are in five-year age bands. For determining the applicable Table 2-2 rate, the employee's age at the end of the calendar year is used.

Once the monthly value has been determined, the value is multiplied by 12 (or the number of months this coverage was provided during the tax year if less) to obtain the annual value of the coverage. The amount of imputed income is equal to the annual value of the excess coverage minus any amounts an employee pays for GTL insurance coverage on a post-tax basis during the year.

## Examples

### Example 1: Employer-Paid Only

Dennis is age 50. He has $100,000 of basic group-term life insurance, and his employer pays the entire cost of the coverage. Because the total policy amount of $100,000 exceeds the statutory exemption of $50,000, Dennis has imputed income.

The calculation of the imputed income is as follows:

1. $100,000 coverage minus $50,000 exemption = $50,000 of taxable coverage
2. Cost per month per $1,000 (Table 2-2) = $0.23
3. Imputed income for $50,000 coverage per month = 50 X $0.23 = $11.50
4. Annual imputed income: 12 X $11.50 = $138.00

***$138.00 will be included on Dennis' W-2 as taxable income and will be subject to FICA.***

### Example 2: Employer and Employee Paid

Dennis is age 50. His employer provides $100,000 of base GTL insurance, and Dennis elects an additional $100,000 of supplemental GTL insurance[16] for which he pays $0.35 per $1,000 of coverage, or $35 per month, on an after-tax basis.

The calculation of imputed income is as follows:

1. $200,000 total coverage minus $50,000 exemption = $150,000
2. Cost per month per $1,000 (Table 2-2) = $0.23
3. Dennis' after-tax contribution per month = 100 X $0.35 = $35
4. Imputed income for $150,000 coverage per month = 150 X $0.23 = $34.50
5. However, we subtract Dennis' after-tax contributions of $35 per month

*Imputed amount = $0*

***Because Dennis paid more than the Table 2-2 rate for his age group on an after-tax basis, his imputed income is $0.***

### Example 3: Employer and Employee Paid

What if Dennis had paid only $0.20 per $1,000 of coverage ($20 per month)? The calculation would show a very different result:

1. $200,000 coverage minus $50,000 exempt = $150,000
2. Cost per month per $1,000 (Table 2-2) = $0.23
3. Dennis' after-tax contribution per month = 100 X $.20 = $20
4. Imputed income for $150,000 coverage per month = 150 X $0.23 = $34.50
5. Subtract Dennis' after-tax contributions of $20 per month = $14.50

*Imputed amount = 12 X $34.50 = $414*

*Less Dennis' annual after-tax contribution of $240*

*Total annual imputed income = $174*

***Because Dennis paid an amount less than the Table 2-2 rate for his age group, the excess amount is imputed as taxable income ($174 in additional taxable income).***

*[16] The rates for employer's supplemental coverage straddle the Table 2-2 rates (at least one employee pays less than the applicable Table 2-2 rate and at least one employee pays more than the applicable Table 2-2 rate). As a result, the supplemental coverage constitutes GTL insurance coverage subject to IRC Section 79.*

## Imputing Income for Discriminatory Plans

For group-term life insurance plans that discriminate in favor of key employees with respect to eligibility or benefits, key employees would not be eligible for the income tax exclusion on the first $50,000 of coverage.[17] For this purpose, key employees are defined as employees who, during the plan year, were: (1) officers earning over $130,000 per year (indexed for inflation[18]); (2) more than 5% owners of the company; and (3) more than 1% owners of the company earning over $150,000 per year (not indexed).[19]

GTL plans are subject to the following nondiscrimination requirements[20]:

1. Eligibility test – A GTL plan generally passes this test if it satisfies one of four alternative tests:
   a. Cafeteria Plan Test – the GTL plan is part of the employer's Section 125 plan (i.e., employees are able to pay GTL premiums on a pre-tax basis) and the Section 125 plan passes the Section 125 eligibility test.
   b. 70% Test – the GTL plan benefits/covers at least 70% of all employees (determined on a controlled group basis).
   c. 85% Test – at least 85% of the GTL plan's participants are non-key employees.
   d. Reasonable Classification Test – the GTL plan benefits employees who qualify under a classification set up by the employer and found by the IRS not to be discriminatory in favor of key employees.[21]

2. Benefits Test – A GTL plan generally passes this test if the type and amount of benefits available to key employees are available to non-key employees. The amount of benefits will be non-discriminatory if:
   a. The amount of coverage available bears a uniform relationship to total compensation or basic/regular rate of compensation for all eligible employees.
   b. The same fixed amount of coverage is available to all eligible employees.
   c. The GTL plan is broken up into rate groups, and each rate group independently passes the eligibility test. A rate group consists of a key employee and all other participants (including other key employees) who receive coverage that is greater than or equal to the amount of the key employee's coverage (determined as a multiple of compensation).
   d. It does not discriminate based on all the facts and circumstances.

When the GTL plan is discriminatory, the employer must add the value of the group-term life insurance coverage, based on the entire amount provided, to the key employee's W-2 earnings. This imputed income is not subject to income tax withholding, but it is subject to employer FICA and employee FICA withholding. The taxable value for key employees is the greater of the actual cost of coverage or the benefit amount (in $1,000 multiples) times the applicable Table 2-2 rate. The actual cost for this purpose is determined under an apportionment formula in the regulations and will not necessarily be the same as the rates charged by the insurer for key employees' coverage.

**Note:** For the purpose of determining whether or not the coverage provided for key employees is discriminatory, both employer-paid and employee-paid benefits are included. Nondiscrimination testing is recommended.

*[17] See Treas. Reg. § 1.79-4T Questions and answers relating to the nondiscrimination requirements for group-term life insurance.*
*[18] Inflation adjustments are determined annually and published in an IRS Notice entitled "Limitations Adjusted as Provided in Section 415(d), etc."*
*[19] Ownership attribution rules apply when determining an employee's ownership interest.*
*[20] Certain church plans are exempt. Furthermore, under the regulations, sponsors of governmental plans do not have any key employees making the requirements inapplicable to those plans as well.*
*[21] The test generally is similar to the eligibility test applicable to Section 125 plans.*

### Example 4: Key Employee Discriminatory Plan Design

What if Dennis' employer had a discriminatory plan design (e.g., the employer-provided $200,000 in GTL coverage for key employees and $50,000 in GTL coverage for all others)? Assuming Dennis is a "key employee" for the year, the amount of his imputed income for GTL would be calculated in the following manner:

1. $200,000 coverage minus $0 (exemption not applicable) = $200,000
2. Table 2-2 rate per month per $1,000 = $0.23
3. Table 2-2 value per month = $200 X $0.23 = $46.00
4. Actual cost per month = $43.00
5. Imputed income per month = $46.00

***Total Annual Imputed Income = $46.00 X 12 months = $552.00***[22]

## Employer-Provided Dependent Life Coverage

Under the IRS rules, there is only a very limited income exclusion for employer-provided dependent group-term life insurance (covering the life of the employee's spouse or dependents). Employer-provided coverage is coverage for which the employer pays all or a portion of the premium. If the employee pays the full premium for the dependent coverage,[23] there is no potential taxation (apart from the after-tax nature of the premium payments).

The exclusion only applies if the benefit qualifies as a "de minimis" benefit. See IRS Notice 89-110. Determination of the de minimis status of the benefit varies depending on whether the employer pays the entire premium:

- **Employer-Paid Only –** De minimis in this situation is defined by the IRS as a coverage with a face amount of $2,000 or less.
- **Employer and Employee-Paid –** According to Notice 89-110, "in determining whether employer-provided dependent group-term life insurance with a higher face amount [i.e., a face amount in excess of $2,000] is a de minimis fringe benefit, only the excess (if any) of the cost of such insurance over the amount paid for the insurance by the employee on an after-tax basis shall be taken into account." The meaning of this statement is unclear. It could mean that the coverage constitutes a de minimis benefit if the excess portion of the life insurance coverage (i.e., the portion the cost of which is not paid by the employee) does not exceed $2,000. Or, as stated in IRS Publication 15-B, it could mean that the coverage constitutes a de minimis benefit "if the excess (if any) of the cost of insurance over the amount the employee paid for it on an after-tax basis is so small that accounting for it is unreasonable or administratively impracticable." Employers should seek legal or tax advice from their own advisor regarding this situation.

If the "de minimis" exception does not apply, the full value of the employer-provided dependent term life insurance coverage is imputed as income in the employee's W-2 earnings. The value of the employer-provided dependent term life insurance coverage is determined based on the Table 2-2 rates. The imputed income in this situation must be reported as wages in the employee's Form W-2. It also is subject to income tax withholding, FICA and FICA withholding.

*[22] We've made an assumption that the Table 2-2 value is greater than the actual cost of the the coverage for purposes of this example.*
*[23] Premiums for dependent life insurance must be paid with after-tax dollars. Dependent life insurance is not a qualified benefit for purposes of IRC Section 125 (i.e., there is no way for employees to pay them on a pre-tax basis).*

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