WRMarketplace
An AALU Washington Report

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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Implementing and Operating Group-Term Life Insurance Plans – The Fundamentals.

MARKET TREND: We are seeing more forms of company-sponsored, guaranteed issue group life insurance coverage, as they can offer valuable life insurance coverage to employees on an efficient basis.

SYNOPSIS: Under a properly structured group-term life insurance plan, employers can provide employees with group-term life insurance coverage of up to $50,000 without subjecting employees to taxation. If the plan provides a higher level of coverage, the employee includes in income the amount, as specified under applicable regulations, which is attributable to the excess coverage, and which may be significantly less than the cost of obtaining such coverage in the market. If the plan discriminates in favor of key employees, however, those employees must include in income an amount based on the full value of the coverage they receive, and the amount of the income inclusion may be determined at a higher rate.

TAKE AWAYS: Group-term life insurance can provide a valuable benefit to employees with minimal income tax consequences. While all employees will likely appreciate the employer-provided coverage, it can be particularly meaningful to those individuals who cannot otherwise obtain or afford life insurance protection. Advisors should familiarize themselves with the federal tax rules governing group-term life insurance plans so that they can counsel their employer-clients on the potential benefits offered by, and the implementation requirements for, such plans.

MAJOR REFERENCES: *Internal Revenue Code ("Code") § 79; Treas. Reg. § 1.79-1, § 1.79-2, § 1.79-3 and 1.79-4T.*

Employer-provided, group-term life insurance can offer valuable benefits to employees on an efficient basis. The group plan can provide death benefit coverage of up to $50,000 to an employee without generating any reportable, taxable income. In addition, the group plan can offer coverage in amounts greater than $50,000, with income imputed to the employee based on the deemed cost of the excess coverage, which is typically calculated more favorably than the actual cost of purchasing similar, individual coverage on a retail basis. To afford these benefits, however, a group-term life insurance plan must meet requirements set forth in the Code and applicable Treasury Regulations, as discussed below.

WHAT IS GROUP-TERM LIFE INSURANCE?

Applicable regulations define "group-term life insurance" as life insurance that meets four requirements:

1. The insurance must provide a ***general death benefit*** that is ***excludable from income***;

2. It must be provided to a ***group of employees***;

3. The insurance must be provided under a policy that is ***carried directly or indirectly by the employer***; and

4. The amount of insurance provided to each employee must be computed under a formula that ***precludes individual selection***.

General Benefit. In practical terms, the requirements necessitate that the policy provide a general benefit and not merely amounts payable upon death during business travel or as the result of an accident. It is not uncommon, however, for an employer to provide business travel insurance and accidental death benefit insurance in addition to group-term life insurance.

Group of Employees (Ten-Employee Test). While a group-term life insurance arrangement generally must cover at least ten employees, such a plan may cover fewer employees if it covers all of an employer's full-time employees or, if the insurer requires evidence of insurability, it covers all employees who provide acceptable evidence to the insurer. The insurer, however, may not require anything more than the completion of a questionnaire to establish insurability; a physical examination cannot be required. In addition, the coverage amount provided must be determined either as a uniform percentage of the employees' pay or as specified in the insurer's coverage brackets, which meet requirements as set forth in the applicable regulations.[1]

> ***Note: Special Considerations in Determining Employees***. In determining "employees" for group-term life insurance purposes, 2% shareholders of an S corporation are not treated as employees of the S corporation. Thus, there is no exclusion for any portion of group-term life insurance coverage provided to such a shareholder. Further, the term "employee" does not encompass the spouse or dependents of an employee, although death benefit coverage of up to $2,000 may be provided on the life of an employee's spouse or dependent without an income inclusion under other rules relating to fringe benefits.

Policy Carried By the Employer. A life insurance policy will be considered carried directly or indirectly by an employer if the employer (1) pays any cost of the life insurance or (2) arranges for the premium payments, and the premiums paid by at least one employee subsidize those paid by at least one other employee.

Precluding Individual Selection. To compute the insurance coverage amount provided to each employee under a formula that precludes individual selection, the formula must be based on factors such as age, years of service, compensation, or position.

WHEN ARE AMOUNTS INCLUDIBLE IN EMPLOYEES' INCOME?

Coverage Over $50,000. Generally, while the first $50,000 of coverage is excludable from employees' income, the cost of coverage over that threshold is includible. The basis for computing the amount of the income inclusion is set forth in applicable regulations, which require the calculation of the monthly cost of the excess coverage in accordance with the table below:

TABLE: Cost per $1,000 of Protection for One Month

Age	Cost
Under 25	$0.05
25 through 29	$0.06
30 through 34	$0.08
35 through 39	$0.09
40 through 44	$0.10
45 through 49	$0.15
50 through 54	$0.23
55 through 59	$0.43
60 through 64	$0.66
65 through 69	$1.27
70 and older	$2.06

The income inclusion is the amount determined under this table for the year, less the amount, if any, contributed by the employee for the coverage.

Plan Discrimination in Favor of Key Employees. In addition, amounts attributable to coverage provided to "key employees" are includible in income, even with respect to the first $50,000, if the group-term life insurance plan discriminates in favor of key employees. For this purpose, a "key employee" during 2015 is an employee who is or was (1) an officer having annual pay in excess of $170,000, (2) a 5% owner of the employer, or (3) a 1% owner of the employer whose annual pay was more than $150,000.

Also, for purposes of this income inclusion:

- ***Eligibility to Participate***. A group-term life insurance plan must not discriminate in favor of key employees as to eligibility to participate (in this regard, a plan will not be considered to discriminate in favor of key employees if either (a) the plan benefits at least 70% of all employees or (b) at least 85% of the employees who are participants under the plan are not key employees); and

- ***Available Benefits***. The type and amount of benefits available under the plan do not discriminate in favor of participants who are key employees (a plan will not be considered to discriminate on this basis if the amount of life insurance on behalf of the employees under the plan bears a uniform relationship to the compensation of the employees covered under the plan).

If a plan is determined to discriminate in favor of key employees, the key employees will have income based on the cost of the total amount of life insurance coverage they receive, which is calculated as the greater of (1) the amount calculated under the table shown above and (2) the actual cost of the premiums paid by the employer for the coverage.

TAKE-AWAYS

- Group-term life insurance can provide a valuable benefit to employees with minimal income tax consequences.

- While all employees will likely appreciate the employer-provided coverage, it can be particularly meaningful to those individuals who cannot otherwise obtain or afford life insurance protection.

- Advisors should familiarize themselves with the federal tax rules governing group-term life insurance plans so that they can counsel their employer-clients on the potential benefits offered by, and the implementation requirements for, such plans.

NOTES

[1] There is a second exception to the ten-employee requirement that covers certain situations in which insurance is mandatory for all employees who belong to or are represented by an organization, such as a union.

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