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Section 79 – Employer Provided Group Term Life Insurance

Since year end is quickly approaching we thought it would make sense to remind you of the Internal Revenue Code (IRC) Section 79 rules and that you may need to include the imputed value of life insurance on your employee's Form W-2.

Section 79 provides the regulations for the taxation of employer provided life insurance. This code specifies how employees are taxed on the value of their group term life insurance and provides a table (Table 2-2) which employers must use in calculating the taxable income that must be added to the taxable income shown on an employee's W-2 tax form.

Section 79 provides that employees are generally not taxed on the first $50,000 of group term life insurance coverage. Table 2-2 is used to determine the taxable income that must be attributed (imputed) to the employee for any amounts of insurance above this excluded amount. Imputed income is included in wages for federal and state income and employment tax purposes. However, it is generally not subject to Federal income tax withholding rules. Imputed income under Section 79 is subject to Social Security Tax (FICA) since such income is considered as "wages" and must be reported on an employee's W-2 tax form. Withholding of the employee's share of the FICA tax is also required.

There are five areas of your group term life and/or voluntary life insurance plan which must be considered and reviewed:

I. **Employer Paid Group Term Life**
II. **Key Employees and S Corporation Shareholders**
III. **Spouse and Dependent Life Insurance**
IV. **Voluntary Life Insurance Plans**
V. **Special Rule For Groups With Fewer Than 10 Employees**

If it is determined that imputed income must be reported, the employer should use the appropriate format:

- For an Employee – use Form W-2 Wage and Tax Statement
- For an Independent Contractor – use Form 1099-MISC, Miscellaneous Income
- For a Partner – use Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.

I. Employer Paid Group Term Life

Under Internal Revenue Code Section 79, Employers can provide up to $50,000 in Group Term Life Insurance to an employee on a tax free basis. The value of employer provided life insurance coverage that exceeds $50,000 must be treated as imputed income to the employee. The value of that coverage is determined based on IRS Table 2-2 (see below).

II. Key Employees and S Corporation Shareholders

If the group term life policy favors key employees as to participation or benefits, you must include the entire cost of the insurance in your key employees' wages. For this purpose, the cost of the insurance is the greater of either premiums you pay or the cost using Table 2-2 (see below). For this exclusion, a key employee is:

1. An officer having annual pay of more than $160,000.
2. An individual who was either:
   a. A 5% owner of your business.
   b. A 1% owner of your business whose annual pay was more than $150,000.

Your plan does not favor key employees as to participation if at least one of the following is true:

1. It benefits at least 70% of your employees.
2. At least 85% of the participating employees are not key employees.
3. It benefits employees who qualify under a set of rules you set up that do not favor key employees.

If the plan pays the same multiple of earnings for all eligible employees, the plan would not favor Key employees even though their benefit is likely to be greater than many other employees.

S Corporation Shareholders. You cannot treat a 2% shareholder of an S Corporation as an employee for this exclusion, you must include the cost of all group term life insurance coverage you provide the 2% shareholder in his or her wages.

III. Spouse & Dependent Life Insurance

If the employer purchased life insurance on behalf of the employee's spouse or dependents, the $50,000 exemption under IRC Section 79 does not apply. However, IRC Section 132 provides a limited exception if the value of the policy is $2,000 or less.

If the employee pays for the dependent life insurance this amount is not taxable. Employees purchasing life insurance on a spouse or dependents must do so on an after-tax basis. This coverage is a non-qualified benefit and should not be included in Section 125 cafeteria plan.

If the value of employer paid for spouse or dependent life insurance exceeds $2,000 the value of that coverage is determined based on IRS Table 2-2 (see below) and should be reported on the employees Form W-2.

IV. Voluntary Life Insurance Plans

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. Since not all voluntary life insurance policies will satisfy the IRC Section 78 definition of group term life insurance you may want to check with your insurance carrier.

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 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), which means it must pass the "Straddle Test."

If the rates for the voluntary group term life insurance straddle the IRS Table 1 rates (see below), meaning that the plan's rates are both above and below the table, then the policy is deemed to be carried by the employer. In that situation imputed income will apply. If the rates do not straddle the Table 2-2 rates, then the policy is not carried by the employer.

V. Special Rule for Groups With Fewer Than 10 Employees

Generally, life insurance is not group-term life insurance unless it is provided to at least 10 full-time employees at some time during the year. There are exceptions to the 10-employee rule, including when all full-time employees are provided coverage or, if evidence of insurability is required. Please see IRS Publication 15-B "Employers Tax Guide to Fringe Benefits," for additional information.

IRS Table 2-2

5- Year Age Bracket based on age at end of tax year	Monthly Cost per $1,000 of 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 older	$2.06

For Additional Information:
IRS Publication 15-B "Employers Tax Guide to Fringe Benefits" is on the IRS website at:
http://www.irs.gov/pub/irs-pdf/p15b.pdf

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