Life Insurance and Imputed Income

GROUP TERM LIFE INSURANCE

The Internal Revenue Service (IRS) considers employer-provided term life insurance in excess of $50,000 for employees a benefit that is taxable as imputed income. As a result, those employees who are insured with an employer-provided life benefit in excess of $50,000 must pay additional taxes for the benefit.

The cost of employer-provided group term life insurance that exceeds $50,000, less any amount the employee pays for coverage in any year with after-tax dollars, must be included in the employee's taxable compensation for the year.

Group Term Life Table 1 Rates

Age Bracket	Cost Per $1,000 of Coverage Per Month
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 & above	2.06

How is the amount of the employee's taxable compensation calculated?

The amount of taxable income on coverage in excess of $50,000 is referred to as "imputed income." The annual imputed income calculation is figured for each employee using the following formula:

[(Total group term coverage - $50,000)/1,000 (rates are per thousand) x Table 1 rate for employee's age x 12 months] minus employee after-tax life insurance contributions for the year. Note that the cost of the coverage is based on the Table 1 rate, not the rate the employer is actually paying to the insurer.

Example: Assume that an employee is 48 years old, earns $65,000 per year and contributes $6 per month toward the cost of life insurance. Assume the employer's plan is 2x salary. Therefore, the employee's life insurance benefit is $130,000 ($65,000 x 2) minus $50,000 = $80,000, the amount on which the employee must pay imputed income taxes. To calculate how much the employee will pay, divide $80,000 by $1,000 (rates are per thousand), then multiply by .15 (from Table 1 rates) = $12.00 per month. Less $6.00 premium equals $6.00. $6.00 per month/$72.00 per year is the imputed income cost for this employee.

The IRS publishes a uniform premium table (above) that is used to determine how much compensation income to include. The IRS table is normally referred to as the "Table 1" cost. For these purposes, the employee's age on the last day of his/her taxable year is used (e.g., December 31 for a calendar year taxpayer).

VOLUNTARY LIFE INSURANCE

Is imputed income required for voluntary life insurance programs when the employee pays the premiums?

In some cases, yes. Many employers are not aware that they may need to calculate imputed income for employee-paid voluntary life insurance plans. Your firm will need to review its voluntary life age bands to determine whether imputed income needs to be calculated for certain employees. The key question to ask: Is the employee's optional life insurance plan deemed to be "carried" by the employer?

Optional life insurance plans are considered to be employer "carried" if the employee-paid plan rates crossover or straddle the IRS Table 1 rates. Crossover or straddling means some rates are equal to or below Table 1 rates, and some are equal to or above Table 1 rates.

[continued]

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If all rate tiers are not completely above or not completely below Table 1 rates, then certain age brackets benefit more from the employer-sponsored group life insurance plan. Income must be imputed for the value of the coverage for rate tiers that fall below Table 1.

If an age band for a group of employees straddles Table 1 rates, both employer-paid and voluntary life coverage must be included when each affected employee's Section 79 imputed income is determined.

Almost all organizations design voluntary life insurance plan deductions to be taken after tax to avoid additional imputed income calculations.

Age Bracket	Table 1 Rates Per $1,000 of Coverage Per Month	Employer Rates Per $1,000 for Additional Coverage Per Month
Under 25	.05	.06 (above Table 1 rates)
25-29	.06	.07 (above Table 1 rates)
30-34	.08	.09 (above Table 1 rates)
35-39	.09	.10 (above Table 1 rates)
40-44	.10	.11 (above Table 1 rates)
45-49	**.15**	**.12 (below Table 1 rates)**
50-54	.23	.24 (above Table 1 rates)
55-59	.43	.44 (above Table 1 rates)

Example of a crossover with imputed income calculation: For this example, the voluntary life insurance plan also allows employees to buy an extra $50,000, $100,000 or $200,000 in voluntary coverage with after-tax dollars. Assume the employee is 46 years old, buys an extra $100,000 in voluntary life coverage, and has a voluntary life insurance rate of $0.12 per $1,000 in coverage. This rate is $.03 lower than the IRS Table 1 rate of $0.15 per $1,000. Next, determine the imputed income per month: $100,000/1,000 (rates are per thousand) x $0.15 (Table 1 rate for age 46) = $15.00. Then determine the premium for optional life insurance paid on an after-tax basis: $100,000/1,000 = 100 x $0.12 (optional life insurance rate) = $12.00. Now subtract the optional premium for imputed income calculation: $15.00 - $12.00 = $3.00 a month. $3.00 per month/$36.00 per year is the imputed income cost for this employee.

DEPENDENT LIFE INSURANCE

If the face amount of the coverage on the life of an employee's spouse and dependents is less than or equal to $2,000 each, the premium is not taxable. An exception to this is when the coverage is being provided for a domestic partner, in which case the full cost is taxable.

If the face amount exceeds $2,000 per covered dependent, the cost of the coverage, less the employee's contribution, is considered taxable income. The cost of this coverage is again determined by using Table 1 rates. The $50,000 exclusion for employee coverage does not apply.

ACTIONS TO TAKE

Employers should review your company's group life insurance plans to determine whether imputed income should be calculated for your employees. Section 79 of the Internal Revenue Code requires imputed income to be calculated if:

- Your organization provides employer-paid coverage that exceeds $50,000.
- Your life insurance plan favors key employees. In this case, calculate imputed income on the full value of the life insurance provided to these key employees.
- Your organization offers voluntary life insurance coverage and the plan's age banded rates crossover or straddle Table 1 rates. In this case, calculate imputed income for employees whose rates fall below the Table 1 rates.
- Your firm provides more than $2,000 of life insurance coverage for dependents.

This article is intended as an overview and should not be viewed as legal or tax advice. Please consult with your attorney or tax advisor if you have any questions.

321 North Clark Street • Chicago, Illinois 60610 • 312-595-6200
One Oakbrook Terrace • Suite 500 • Oakbrook Terrace, Illinois 60181 • 630-705-2000
610 Central Avenue • Suite 200 • Highland Park, Illinois 60035 • 847-681-2300
www.mesirowfinancial.com