



Presented for

Presented by

U.S. Treasury Circular 230 may require Pentera Group, Inc. to advise you that “any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor.”



## The Concept...

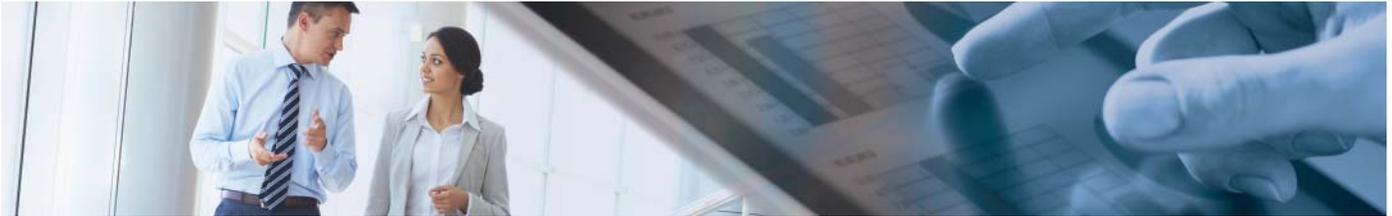
- Federal tax law—Section 79 of the Internal Revenue Code—provides a major incentive for employers to provide a group term life insurance arrangement for employees.
- The employer’s premium payments for group term life insurance are generally tax deductible to the employer provided the employer is not the beneficiary.
- The employer’s cost for the first \$50,000 of employer-provided group term life insurance coverage is excluded from a covered employee’s gross income.
- The death proceeds are not taxed as gross income when they’re paid directly to the employee’s beneficiary.

## Eligibility...

- The employer may be a corporation, limited liability company, partnership or sole proprietorship.
- However, sole proprietors, partners and S corporation shareholder-employees owning more than 2% of the stock aren’t considered eligible employees under the terms of IRC Section 79, so their group term coverage is not excludable from gross income.
- A group term life insurance arrangement generally must cover 10 or more full-time employees at some point during the year.
- A single-employer arrangement covering fewer than that number may be eligible if: (a) it covers all full-time employees; (b) the amount of coverage is determined either as a uniform percentage of compensation or under coverage brackets in which no bracket exceeds specific percentages designed to prevent discrimination;(c) any required evidence of insurability is determined only by a medical questionnaire, not a physical exam, and (d) any other medical information voluntarily provided by the employee is not used to determine premium rates.

## Other Requirements...

- To qualify for favorable tax treatment, the arrangement must provide a “general death benefit” of the type excludable from gross income.
- The employer must provide insurance coverage as compensation to employees whose membership in the group is based solely on age, marital status, length of service, job responsibilities, or some other factor related to employment.



- The coverage must be provided under either a master policy or a group of individual policies carried directly or indirectly by the employer.
- Each employee's coverage must be determined on a basis—such as compensation or years of service—that prevents individual selection.
- If the group term arrangement fails to meet these tests, each employee's share of the employer's premiums is includible in his or her gross income.

## The Tax Picture: a Closer Look...

- The cost for group term coverage not exceeding \$50,000 is excludable from an employee's (or retired employee's) gross income. The taxable cost of any excess coverage is determined not by the employer's actual premium for the coverage, but under a special IRS table.
- The amount includible in an employee's (or retired employee's) gross income is reduced by any contribution the employee makes toward purchasing the coverage.
- Group term coverage provided to a disabled employee after termination of employment due to the disability is fully excludable from gross income, without regard to the usual \$50,000 limitation.
- In certain cases, the cost of coverage exceeding \$50,000 may avoid inclusion in a participant's gross income. This is typically the case, for example, if the employer is the employee's sole beneficiary for the entire year.
- If state law limits the coverage an employee may receive to less than \$50,000, the employee is taxed on the excess over the state maximum. The cost is based on the actual premium paid, not on the IRS table.
- Any supplemental group term coverage provided on the employee's spouse and dependents does not count toward the \$50,000 maximum exclusion.
- Generally, the cost of spouse-and-dependent coverage may be excludable from the employee's gross income if its face amount is \$2,000 or less. Higher amounts may produce taxable income to the employee under the IRS table.
- If the arrangement discriminates in favor of "key employees" in terms of eligibility or benefits, key employees must include the cost of the first \$50,000—as well as any excess over \$50,000—in their gross income. The amount is the greater of the IRS table cost or the actual premium. (The cost of the first \$50,000 of coverage is still excluded for rank-and-file employees.)



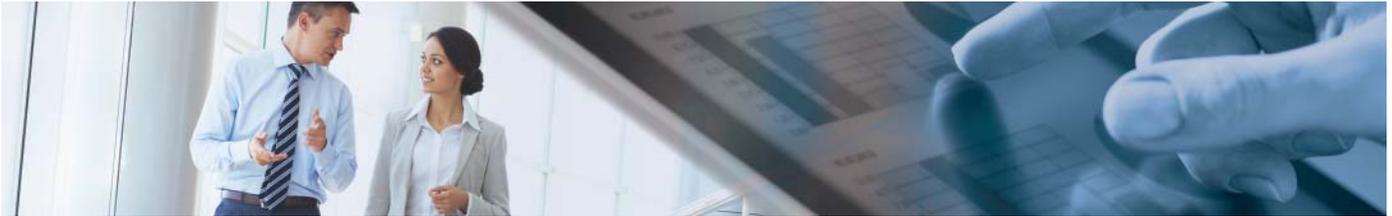
- The definition of “key employee” is based on arithmetic tests relating to compensation or ownership. The compensation figure is indexed and subject to annual change.

## The Business Purchase Question...

- Employer-provided group term life insurance is generally not a good insurance vehicle to fund a buy-sell agreement for the following reasons:
- Under an entity agreement, the employer would lose its tax deduction for the premium since it would be the beneficiary of the insurance. IRC Section 264(a) denies a deduction in situations like this.
- The death proceeds may be taxable as ordinary income if the company is owner and beneficiary and the employer has not met the notice and consent requirements of IRC Section 101(j).
- With a cross-purchase agreement, naming other shareholders as group life beneficiaries could be considered a transfer for value that would disqualify the death proceeds from a full income-tax exclusion.

## The Bottom Line...

Group term life insurance provides a solid foundation to a comprehensive employee benefit program, backed up by government assistance in the form of valuable tax incentives to both employers and the employees.



## Summary

### What Is Group Term Life Insurance?

Employers can establish a group term life insurance arrangement under Internal Revenue Code Section 79 that provides tax-advantaged coverage to employees.

The employer may be a corporation, limited liability company, partnership or sole proprietorship. However, sole proprietors, partners, and S corporation shareholder-employees owning more than 2% of the company stock aren't eligible employees for purposes of group term life coverage under IRC Section 79, so their group term coverage is not excludable from gross income.

To qualify for the tax advantages, a group term life insurance arrangement cannot discriminate in favor of "key employees" with respect to either eligibility or benefits. The definition of "key employee" is governed by arithmetic tests relating to compensation or ownership, and is subject to annual inflation adjustment.

### What Are the Tax Benefits?

The employer can generally deduct the premiums it pays for group term life insurance coverage on employees, provided the employer is not the beneficiary of the coverage.

The employees can exclude from their gross income the employer-paid costs of the first \$50,000 of group term life coverage. Any coverage in excess of that amount is taxed to the employee under favorable rates in an IRS table.

If the employee dies while the coverage is in effect, the death proceeds are generally excludable from the beneficiary's gross income.

### How Does It Work?

An employer's group term life insurance arrangement must meet several requirements to qualify for favorable tax treatment under IRC Section 79:

1. It must provide a "general death benefit" of the type excludable from gross income.
2. The employer must provide the coverage as compensation for services to employees whose membership in the group is based solely on age, marital status, length of service, job responsibilities, or some other factor related to employment.
3. The insurance coverage must be provided under either a master policy or a group of individual policies carried directly or indirectly by the employer.
4. The amount of each employee's coverage must be determined on some basis—such as compensation or years of service—that precludes individual selection.



If the arrangement fails to meet all four of these tests, each employee's share of the employer's premiums is includible in the employee's gross income.

### **What Are the Advantages to the Employer?**

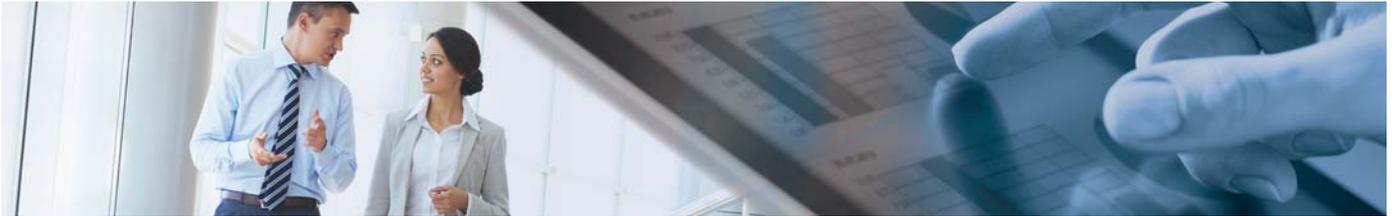
Premium payments are generally deductible. Current employees are more likely to remain with the company and to be productive if they have a basic level of life insurance protection for their survivors. Potential recruits often expect basic group life coverage when considering employment.

### **What Are the Advantages to the Employee?**

The employee secures up to \$50,000 of employer-paid group term life insurance coverage without having to include the employer-paid cost in gross income. Death proceeds received by the employee's beneficiary are generally income tax free.

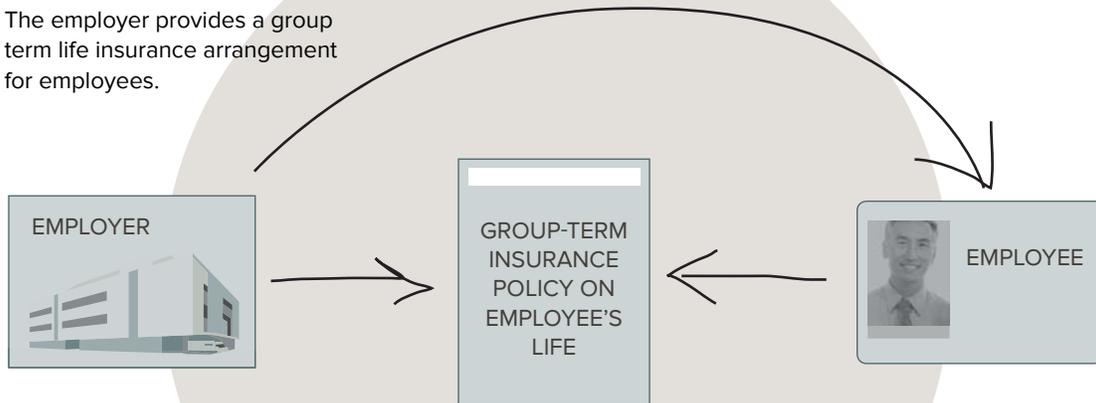
### **What's the Overall Result?**

Employees secure a valuable addition to their fringe benefit package in the form of needed life insurance protection, with the cost paid partially or wholly by the employer. And the employer takes advantage of low group term life premium rates to provide this valuable benefit to employees.



1

The employer provides a group term life insurance arrangement for employees.



2

The employer pays some or all of the premiums to the insurance company. Premiums are tax-deductible.

3

The employee may contribute toward premiums on a nondeductible basis. The employee is not taxed on the first \$50,000 of employer-paid coverage, but pays the taxable cost of any excess. The employee's after-tax contributions, if any, reduce the amount includible in compensation.



Copyright © 2004-2016, Pentera Group, Inc. 921 E. 86th Street, Suite 100, Indianapolis, Indiana 46240.  
All rights reserved.

This service is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that neither the publisher nor any of its licensees or their distributees intend to, or are engaged in, rendering legal, accounting, or tax advice. If legal or tax advice or other expert assistance is required, the services of a competent professional should be sought.

While the publisher has been diligent in attempting to provide accurate information, the accuracy of the information cannot be guaranteed. Laws and regulations change frequently, and are subject to differing legal interpretations. Accordingly, neither the publisher nor any of its licensees or their distributees shall be liable for any loss or damage caused, or alleged to have been caused, by the use of or reliance upon this service.

U.S. Treasury Circular 230 may require Pentera Group, Inc. to advise you that “any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor.”