

DREGGORS, RIGSBY & TEAL, P.A.

CERTIFIED PUBLIC ACCOUNTANTS

Group Term Life Insurance

Group term life insurance is simply term insurance issued to people who belong to a group that has a common interest or association, such as an employer, a trade, or a school affiliation. Premiums increase annually or in "bands" of three- or five-year periods. Group term life insurance offers pure financial protection against premature death (there is no cash value component with term insurance, as there is with permanent insurance). For an employer, group term life insurance is a convenient way to offer employees easy-to-buy, affordable life insurance coverage.

Employers often provide a flat amount of coverage, such as \$10,000 per employee. Many employers offer coverage that is a multiple of an employee's earnings, such as two times his or her annual salary.

Eligibility information

As an employer, you can choose to include all of your employees in a group term life insurance plan, or select only a class of employees, such as managers. You can also exclude certain employees from coverage. For instance, you could require employees to work a minimum number of hours per week, such as 20, before they would qualify for coverage. You could also exclude employees based on the number of months worked per year, such as requiring at least five months of work in order to obtain coverage. Or, employees may have to have been employed for a certain period of time before they are eligible to participate.

A business can start group coverage with as few as 2 employees, though most employers begin thinking about offering coverage when they have 10 or more employees. The number of employees may determine whether an insurer will offer immediate coverage without evidence of insurability. Plans that limit coverage to \$50,000 or less usually skip any medical underwriting requirements; amounts over \$50,000 may require individuals to answer medical questions and satisfy underwriting standards to be accepted.

Bells and whistles

Some group term policies may offer supplemental coverage (for a spouse) or dependent coverage (for children). These coverage amounts often carry limitations. For instance, the spousal coverage may be limited to 50 percent of the employee's amount, while dependent coverage may be a flat amount, such as \$2,000.

Some policies also offer an accelerated death benefit that allows an employee with a terminal illness to collect a percentage of his or her coverage in advance. When employees leave your firm or retire, they may also be able to keep the coverage as personally owned term insurance, or convert the group term to permanent life insurance. Available options vary among insurers, so be sure to ask about features that are important for your business needs and for your employees.

What's in it for the employees?

Essentially, group term coverage can represent free life insurance for an employee. But because many employers limit group term coverage to \$50,000, employees should often think of this coverage as supplemental to their own personal life insurance plans, not as their main source of protection.

Employers often stop at \$50,000 of coverage for tax reasons. The cost to provide coverage of up to the \$50,000 limit is deductible by the employer but not includable in the income of the employee. Also, an employee's beneficiary will not pay federal income taxes on the death benefits. A state may, however, require income taxes on the death benefits.

Employers that pay for more than \$50,000 of group term coverage must include the "economic value" of the cost of the excess insurance as taxable income to the employee (reported on their W-2s as "additional compensation"). One way around these limitations is for an employer to pay for the first \$50,000 of coverage and allow employees to pay for any optional coverage in excess of this amount.

What's in it for the employer?

As the employer, you can offer different coverage amounts for different classes of employees. For example, you might buy \$50,000 of coverage for your customer service personnel, but buy coverage for your engineers equal to three times their annual salaries. The downside is that if you do "discriminate" among different classes of employees, the economic value of the cost of the first \$50,000 of coverage may be taxable to your key employees (i.e., certain officers, highly compensated individuals, and owners with 5 percent or more ownership).

As mentioned, you may pay all or part of the cost of group life coverage, and many employers pass on the costs of any additional features to their employees. The good news, from a federal income tax standpoint, is that group term life premiums paid by an employer are tax deductible by the business, even if your plan is discriminatory.

Also note that the way your business is organized will affect your business tax benefits. Owners of more than 2 percent of an S corporation, partners, and sole proprietors are not considered employees, so premiums paid for their group term insurance are generally not tax deductible. In a corporation that is not an S corporation, premiums paid for all employees (including owner-employees) are generally tax deductible.

Cost concerns

Typically, you can expect to pay a set amount per \$1,000 of coverage per employee (e.g., \$.10 per \$1,000 per month). Premium costs depend on the coverage amounts you want to provide and whether medical underwriting is required. Premium costs will also depend on the number of employees, their ages, their genders, and the type of business you operate. For instance, a commercial fishing fleet will probably pay more in premiums than a bookstore.

For any type of business, though, you can expect costs to rise as your employee population ages. In general, the larger the group of employees, the lower the premium charged. And just like many group health plans, an insurer may also charge higher life insurance premiums for smokers than for nonsmokers.