

Employer-provided group-term life insurance

Does your employer provide you with group term life insurance? If so, and if your salary is higher than \$50,000, this employee "benefit" may be creating undesirable income tax consequences for you. Here's why.

The first \$50,000 of group term life insurance coverage that your employer provides is excluded from taxable income and doesn't add anything to your income tax bill. But the employer-paid cost of group term coverage in excess of \$50,000 is taxable income to you even though you never actually receive it (i.e., it is "phantom income"). What's worse, the cost of group term insurance must be determined under a table prepared by IRS even if the employer's actual cost is less than the cost figured under the table. Under this table, the amount of taxable phantom income attributed to an older employee will often be higher than the premium the employee would pay for comparable coverage under an individual term policy. This tax trap gets worse as the employee gets older and as the amount of his compensation increases.

What should you do if you think you might be one of the people for whom the tax cost of employer-provided group term life insurance is undesirably high? First, you should determine if this is actually the case. If a specific dollar amount appears in Box 12 of your Form W-2, that dollar amount represents your employer's cost of providing you with group-term life insurance coverage in excess of \$50,000, less any amount you paid (for example, through withholding). You are responsible for any and all Federal, State, and City taxes on the amount in Box 12, and for the FICA tax (Social Security and Medicare) as well. But keep in mind that the amount in Box 12 is already included as part of your total "Wages, tips and other compensation" in Box 1 of the W-2, and it's the Box 1 amount that's reported on your tax return. If you are unsure how much your group term coverage is adding to your tax bill, I'd be happy to look into the situation for you and let you know.

If you then decide that this cost is too high for the benefit you're getting in return, you should find out whether your employer has a "carve-out" plan (a plan that carves out selected employees from group term coverage) or, if not, whether it would be willing to create one. There are several different types of carve-out plans that employers can offer to their employees. For example, the employer can continue to provide \$50,000 of group term insurance (since there's no tax cost for the first \$50,000 of coverage) and either provide the employee with an individual policy for the balance of the coverage, or give the employee the amount the employer would have spent for the excess coverage as a cash bonus that the employee can use to pay the premiums on an individual policy.