



North Carolina Department of State Treasurer

RICHARD H. MOORE
TREASURER

State and Local Government Finance Division
and the Local Government Commission

MEMORANDUM # 1048

March 3, 2006

To: All Local Government Officials and
Certified Public Accountants

From: Sharon Edmundson, Assistant Director
Fiscal Management Section

Subject: W-2 Treatment of Cost of Group Term Life Insurance

***** PLEASE NOTE: THIS IS A REVISION OF MEMORANDUM # 1009*****

Internal Revenue Service (IRS) regulations dictate that the cost of group-term life insurance provided to an employee by his employer for coverage that exceeds \$50,000 is taxable to the employee as a fringe benefit. The cost of the excess coverage also is included in taxable wages for Social Security and FICA calculation purposes. As a result, FICA taxes will be calculated and withheld on the amount of the premium paid for the excess insurance. The employees' W-2 will include the premium for the excess coverage as wages on the taxable Federal Income wage box (box 1), the Social Security Wage box (box 3), the Medicare Wage box (box 5), and the State Wage box (box 16). The amount of the premium for the excess coverage also will be reported in Box 12c as Group Term Life premium. The employer does not have to withhold income tax or pay federal unemployment tax on the imputed income, however.

The IRS defines group term life insurance as insurance that meets the following criteria (Please note – this is a general definition. You should confer with your payroll provider, insurance provider, and auditor to determine if your policy meets the IRS definition of group term life insurance for this purpose.)

- It provides a general death benefit that is not included in income.
- You provide it to a group of employees.
- It provides an amount of insurance to each employee based on a formula that prevents individual selection. This formula must use factors such as the employee's age, years of service, pay, or position.

- You provide it under a policy you directly or indirectly carry. Even if you do not pay any of the policy's cost, you are considered to carry it if you arrange for payment of its cost by your employees and charge at least one employee less than, and at least one other employee more than, the cost of his or her insurance. The IRS has guidance on determining the cost.

Included in the \$50,000 limit is the amount of insurance provided to employees through the Local Government Employees' Retirement System (LGERS) and the Teachers' and State Employees' Retirement System (TSERS). The amount of insurance provided to an employee that is a participant in either of these systems varies based on his or her salary. However, the minimum amount of insurance provided is \$25,000 and the maximum is \$50,000. Employers must be cognizant of the amount the employee is eligible to receive through the applicable retirement system when determining if the employee's total group term life coverage exceeds \$50,000.

The following is an example using these assumptions:

- Employee, age 43, is currently salaried at \$60,000 per year and is eligible for \$50,000 of group life insurance through the LGERS. The City has opted to provide Employee with an additional \$75,000 of term life insurance coverage. Therefore the total life insurance provided to Employee is \$125,000, which exceeds the maximum IRS limit by \$75,000.

The cost of the \$75,000 of insurance is taxable income to Employee for federal, social security, medicare, and state tax purposes. The IRS has published information on calculating the cost of the coverage. Please see IRS Publication 15-B for more information (issued 12/2005; available at <http://www.irs.gov>). Using the IRS tables, the cost of the excess \$75,000 of coverage is determined to be \$ 90.00 per year ($\$75,000/1000 * \$0.10 * 12$). Employee's taxable federal, social security, medicare, and state wages would include \$90 of taxable fringe benefits as a result of the group term life insurance coverage. Box 12c of Employee's W-2 would show \$90 of taxable benefits.

Change the assumptions as follows:

- Employee, age 43, is currently salaried at \$30,000 per year and is eligible for \$30,000 of group life insurance through the LGERS. The City has opted to provide Employee with an additional \$30,000 of term life insurance coverage. Therefore the total life insurance provided to Employee is \$60,000, which exceeds the maximum IRS limit by \$10,000.

The cost of the \$10,000 of insurance is taxable income to Employee for federal, social security, medicare, and state tax purposes. The IRS has published information on calculating the cost of the coverage. Please see IRS Publication 15-B for more information (issued 12/2005; available at <http://www.irs.gov>). Using the IRS tables, the cost of the excess \$10,000 of coverage is determined to be \$ 12.00 per year ($\$10,000/1000 * \$0.10 * 12$). Employee's taxable federal, social security, medicare, and state wages would include \$12 of

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taxable fringe benefits as a result of the group term life insurance coverage. Box 12c of Employee's W-2 would show \$12 of taxable benefits.

Again, we strongly encourage you to consult with your payroll provider, insurance provider, and auditor to determine the taxable nature of the group term life insurance that your unit of government provides. This memorandum is for informational purposes only and should not be relied upon as the only source for information on this issue.

If you have any questions or comments, please contact Sharon Edmundson at (919) 807-2384 or sharon.edmundson@nctreasurer.com.