



# Imputed income and the straddle rule

## Group term life insurance

**Imputed income is the amount of taxable income on group term life insurance coverage in excess of \$50,000.**

Most employees appreciate when group term life insurance is offered as a pre-tax, payroll-deducted benefit they don't have to think about until they need it. But behind the scenes, employers and plan administrators must be aware of the potential tax implications of group term life insurance plans.

Employer-sponsored group term life insurance coverage with benefit amounts over \$50,000 may generate taxable income for employees. Employers are responsible for including this taxable income—known as “imputed income”—as wages on employee W-2 forms, and it is subject to Social Security and Medicare taxes. There are no potential tax consequences if the total benefit amount of employer-sponsored group term life insurance is less than \$50,000.

In addition to the amount of the benefit, the calculation and reporting of imputed income depends on whether the group term life insurance plan is considered “discriminatory,” how premium is paid—employer-paid, employee-paid pre-tax, or employee-paid on an after-tax-basis—and whether the plan is considered “carried” by the employer under Section 79 of the Internal Revenue Code (IRC) and other corresponding regulations. It's important to note that under certain circumstances, even a supplemental group term life insurance plan can be considered carried by the employer.

In this edition of The Inside Track, we'll discuss where imputed income applies and how it's calculated. Please note that this document provides only a high-level overview of the tax consequences of group term life insurance and examples where imputed income may occur. Consult your legal or tax advisor for information on how your actual benefits plan may be affected.

### Determining imputed income for employer-paid coverage

Any group term life insurance policy providing any employer-paid coverage (or coverage paid by employees on a pre-tax basis) will always be considered “carried” by the employer with corresponding imputed income. Employers must calculate and report as imputed income the cost of benefits in excess of \$50,000, reduced by any after-tax amounts the employee paid toward the insurance. It's important to note that the taxable cost of benefits in excess of \$50,000 is not determined by the actual cost of the coverage. Instead, this amount is calculated using an age-banded premium table published by the IRS, known as Table 1.

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| Age bracket  | Monthly cost per \$1,000 of excess coverage |
|--------------|---|
| Under 25     | \$.05                                       |
| 25 to 29     | \$.06                                       |
| 30 to 34     | \$.08                                       |
| 35 to 39     | \$.09                                       |
| 40 to 44     | \$.10                                       |
| 45 to 49     | \$.15                                       |
| 50 to 54     | \$.23                                       |
| 55 to 59     | \$.43                                       |
| 60 to 64     | \$.66                                       |
| 65 to 69     | \$1.27                                      |
| 70 and above | \$2.06                                      |

**The amount of imputed income is calculated using the following formula:**

(Total group term life insurance amount – \$50,000) / \$1,000)

- × Table 1 rate for employee's age
- Employee monthly after-tax contributions
- = Monthly imputed income amount

### Let's review an example:

Jennifer (age 36) works for a company that offers a group term life insurance benefit of three times the employee's salary (\$120,000 for Jennifer), and the employer pays the entire premium. Using the imputed income formula, here's how Jennifer's imputed income is calculated:

- ① Excess coverage amount: \$120,000 – \$50,000 = **\$70,000**
- ② Monthly cost of coverage: \$70,000 / \$1,000 = \$70 x \$.09 (Table 1 rate) = **\$6.30**
- ③ Monthly taxable amount: \$6.30 – \$0 (employee after-tax contribution) = **\$6.30**

In an effort to avoid the administrative burden of taxing imputed income, many employers limit group term life insurance benefits to \$50,000 and then offer supplemental (voluntary) coverage to employees looking for additional coverage. The challenge is that, under certain circumstances, even supplemental coverage can result in imputed income.

### Supplemental life insurance and the “straddle rule”

There are some instances where supplemental group term life insurance plans may be considered carried by the employer with corresponding imputed income. To avoid being carried, supplemental group term life insurance plans must meet all of the following requirements:

- ① Employees must pay premium for the supplemental plan using after-tax dollars.
- ② If there is a separate employer-paid group term life insurance plan, the insurance premiums and coverage must be properly allocated between the employer-paid plan and the supplemental plan.
- ③ The rates charged under the supplemental life plan for all age groups must be either (a) completely at or above or (b) completely at or below the corresponding Table 1 rates.

Employers may need to calculate imputed income for supplemental group term life insurance benefits, even when the premium is 100% employee-paid.

The straddle rule states that premium rates charged for a supplemental group term life insurance plan for all age groups must be either (a) completely at or above or (b) completely at or below the corresponding Table 1 rates.

The last requirement is often referred to as the “straddle rule.” Straddling occurs when the life insurance rates for one age group of employees are less than the Table 1 rates, and the insurance rates of another employee group are equal to or greater than the Table 1 rates. If the rates charged under the policy for all age groups are neither (a) all completely at or above nor (b) all completely at or below the corresponding Table 1 rates, then imputed income must be calculated and reported for those age groups with employee rates below the corresponding Table 1 rate.

The following table illustrates the straddle rule for determining when imputed income must be reported:

| Table 1 age bracket | Table 1 rate per \$1,000 | Employee rate per \$1,000 | Employee rate vs. Table 1 rate | Imputed income reported? |
|---------------------|--------------------------|---------------------------|--------------------------------|--------------------------|
| Under 25            | \$.05                    | \$.056                    | Over                           | No                       |
| 25 to 29            | \$.06                    | \$.056                    | Under                          | Yes                      |
| 30 to 34            | \$.08                    | \$.062                    | Under                          | Yes                      |
| 35 to 39            | \$.09                    | \$.075                    | Under                          | Yes                      |
| 40 to 44            | \$.10                    | \$.117                    | Over                           | No                       |
| 45 to 49            | \$.15                    | \$.15                     | Equal                          | No                       |
| 50 to 54            | \$.23                    | \$.331                    | Over                           | No                       |
| 55 to 59            | \$.43                    | \$.43                     | Equal                          | No                       |
| 60 to 64            | \$.66                    | \$.808                    | Over                           | No                       |
| 65 to 69            | \$1.27                   | \$1.450                   | Over                           | No                       |
| 70 and above        | \$2.06                   | \$2.596                   | Over                           | No                       |

If any employees in an age group straddle Table 1 rates, the supplemental plan is considered carried by the employer and both the employer-paid and supplemental coverage must be included in the calculation of any affected employee’s imputed income.

Let’s review another example using the rates from the previous table:

Jennifer’s company offers an employer-paid basic group term life insurance benefit of \$40,000. Her employer also provides an employee-paid supplemental group term insurance benefit, of which Jennifer (age 36) elected an additional \$80,000 of coverage.

Jennifer’s monthly premium for the \$80,000 supplemental benefit is \$6.00 ( $\$80,000 / \$1,000 = \$80 \times \$0.075 = \$6.00$ ). The employee rate for Jennifer’s age bracket (\$.075) is below the Table 1 rate (\$.09). Since the employee rate for at least one other age group exceeds the Table 1 rate, the supplemental plan is considered carried by the employer. As a result, the company must include both the employer-paid and supplemental coverage when calculating Jennifer’s imputed income.

Using the formula from the previous page, here is how Jennifer’s employer calculates her imputed income:

- ① Total life insurance amount: \$40,000 (employer paid) + \$80,000 (employee-paid supplemental) = **\$120,000**
- ② Excess coverage amount: \$120,000 – \$50,000 = **\$70,000**
- ③ Monthly cost of coverage:  $\$70,000 / \$1,000 = \$70 \times \$0.09$  (Table 1 rate) = **\$6.30**
- ④ Monthly taxable amount: \$6.30 – \$6.00 (employee after-tax contribution) = **\$0.30**

As a reminder, please consult your legal or tax advisor when reviewing how your benefit plan may be affected.

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## What about dependent term life insurance?

Dependent term life insurance for spouses or children can be offered as employer-paid or supplemental benefits. In either case, if the coverage for any dependent is over \$2,000, the benefit is taxable as imputed income based on Table 1 rates. The entire amount is taxable, not just the amount that exceeds \$2,000.

## Exceptions to the rule

It's important to note that most other types of group insurance coverage are not subject to this imputed income rule, including:

- Accidental death and dismemberment (AD&D)
- Disability insurance
- Travel accident coverage
- Accident policies
- Health coverage

## Get advice

Calculating and reporting imputed income is a complex task. Talk with your tax advisor or employee benefits broker when considering group term life insurance benefits, or when existing plans have unplanned tax consequences. When group term life insurance benefits are carefully constructed, the effects of imputed income can be minimized.

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**For more information on group term life insurance, imputed income and the straddle rule, talk with your group benefits representative or consult a tax advisor.**



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