Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE-PLR-118030-99
Date:
May 12, 2000

In Re:

Legend

Company =

Insurer X =

Dear Mr.

This letter is in response to a request submitted on the behalf of Company by its authorized representatives for rulings concerning Company's group term life insurance program.

Company provides basic group term life insurance on the lives of eligible non-union employees in the amount of 100% of annual compensation, at no cost to the employee. In addition, an eligible employee may purchase supplemental coverage on his or her life, as well as insurance on the lives of the employee's children and spouse.

The supplemental coverage on the lives of the employees is paid for entirely by the employees on an after-tax basis. In the past, the premiums charged to the employees for the coverage made no distinction between smoking employees and non-smoking employees. In an effort to improve the fairness and actuarial soundness of the supplemental coverage for its employees, Company has established a new supplemental plan. Under the new plan, the premium rates charged to the employees are segregated between smokers and non-smokers. For all age groups, the premium charged to smokers are the same as or more than the premium rates of Table I (effective, generally, July 1, 1999) of section 1.79-3(d)(2) of the Income Tax Regulations. For all age groups, the premium charged to non-smokers are the same as or less than the Table I premium rates. Employees may purchase coverage of one-to-five times earnings, not to exceed a specified amount. Some employees, may continue to purchase a reduced amount of coverage after retirement. For the remaining terminated employees, the full amount of the supplemental coverage may be continued

for 18 months after termination.

The coverages for both the basic and the supplemental insurance are purchased from Insurer X. The information submitted evidences that the rate structure for the supplemental life coverage is self-supporting and is not subsidized by the basic life coverage. The premium rates for the supplemental coverage were determined separately and independently of the premium rates for the basic coverage, and the finances of the supplemental and basic coverages will be accounted for separately and independently. For example, the experience rating for each of the plans is separately developed based on historical mortality, interest income, administrative expenses and similar factors; reserves are not shifted between policies; no premium loading expenses allocable to one plan are included in the premiums of the other plan; and, the dividend and rate credits attributable to each of the plans are determined separately from each other, based on independent retrospective adjustments. The information submitted also evidences that the premiums charged to smokers and those charged to non-smokers were developed separately from each other and are self-supporting. For example, separate estimated claim rates were calculated for each class. In the future, the premium rates for each class will be evaluated and adjusted separately. No premium loadings, reserves or experience credits will be shifted from one class to another.

Company now wishes to elect to treat as separate policies, for purposes of section 79 of the Internal Revenue Code, the coverage under the basic policy, the coverage provided to smokers under the supplemental policy, and the coverage provided to nonsmokers under the supplemental policy.

In addition to group-term life insurance coverage on their own lives, employees of Company may also purchase life insurance coverage on the lives of their spouses and children. The coverage, purchased from Insurer X, is paid for entirely by the employee on an after-tax basis. Coverage may be purchased on children in the face amounts of $10,000 per child for a flat premium amount per month. Coverage may be purchased on a spouse in the face amount of $25,000, $50,000, $100,000 or $150,000 at the same rates (using the spouse's age) as coverage purchased on the lives of employees. Although the policies are available to Company's employees because of their employment relationship, the taxpayer represents that the particular rates established by Insurer X for Company's employees are not a product of the employment relationship between Company and its employees. Rather, Company represents that the rates for the spousal insurance coverage perfectly reflect the market value of obtaining supplemental insurance coverage under a group contract, with all of its benefits and limitations. Company requests rulings that the life insurance coverage on the spouses and children does not result in income to the employees.

LAW AND ANALYSIS

Insurance Coverage on the Lives of the Employees

The taxation of employer-provided group term insurance on the life of an employee is governed by section 79 of the Code. Assuming a group term plan meets the non-discrimination requirements of section 79(d), $50,000 of such coverage is excludable from the each employee's income. For coverage above $50,000, section 79 requires an employee to include in income an amount equal to the cost of life insurance provided under a policy carried directly or indirectly by his or her employer (less any amounts paid by the employee toward the purchase of such insurance). Section 79(c) requires the "cost" of the insurance to be computed by using the uniform premiums prescribed in Table I of the section 79 regulations.

Section 1.79-1(a) of the regulations sets forth the conditions that must be met before a policy of life insurance will be considered group term life insurance for purposes of section 79 of the Code. The condition relevant to this ruling request is that the life insurance be "provided under a policy carried directly or indirectly by the employer." Treas. Reg. § 1.79-1(a)(3) of the regulations.

The meaning of the term "policy," for purposes of section 79 of the Code, is found in Treas. Reg. §1.79-0. Under that definition, the term "policy" includes two or more obligations of an insurer (or its affiliates) that are sold in conjunction. Obligations that are offered or available to members of a group of employees are sold in conjunction if they are offered or available because of the employment relationship. These obligations of the same insurer are aggregated despite actuarial sufficiency of the premiums charged for each obligation, and even if the obligations are contained in separate documents. The regulations, however, allow an employer to elect to treat two or more obligations, each of which provides no permanent benefits, as separate policies if the premiums are properly allocated among such policies.

Thus, an employer may have more than one policy. However, each policy must be tested separately to determine if it is carried directly or indirectly by the employer. If a policy is not carried directly or indirectly by the employer, no income will be imputed to an employee under section 79 of the Code on account of the insurance provided under that policy.

The definition of the phrase "carried directly or indirectly by the employer" is also found in Treas. Reg. §1.79-0. Under that definition, a policy of life insurance is carried directly or indirectly by the employer if:

(a) The employer pays any part of the cost of the life insurance directly or through another person; or

(b) The employer or two or more employers arrange for payment of the cost of the life insurance by their employees and charge at least

> one employee less than the cost of his or her insurance, as determined under Table I..., and at least one more than the cost of his or her insurance, determined in the same way.

Applying the above rules to the Company's group term life insurance plan covering the lives of the employees, the basic and the supplemental insurance are available to the Company's employees because of the employment relationship. In addition, both the basic and the supplemental insurance are purchased from the same insurer. Therefore, all obligations contained in the basic and the supplemental plan will be treated as a single "policy" for purposes of section 79, unless the Company meets the conditions to elect to treat such obligations as separate policies. Because neither the basic nor the supplemental coverage contains permanent benefits, the only requirement for electing separate treatment is that the premiums be properly allocated.

Based on the representations made, we conclude that the insurance premiums are properly allocated between the coverage provided under the basic policy and that provided under the supplemental policy, so that the Company may elect to treat the basic coverage as a separate policy for purposes of section 79 of the Code. Because the Company pays the cost of the basic insurance coverage, the life insurance provided under the basic plan is within the definition of "carried directly or indirectly by the employer."

Based on the representations made, we also conclude that the premiums charged for the supplemental coverage: (1) are not financed by the employer, and (2) are properly allocated between the insurance for the smokers and the insurance for the nonsmokers. Furthermore, we conclude that coverage provided to the smokers is a "obligation of an insurer" (as that term is used in the definition of "policy"), as is the coverage provided to the nonsmokers. Because the premiums charged for these obligations are "properly allocated," the Company may elect to treat each of these obligations as a separate policy for determining whether the insurance is within the definition of "carried directly or indirectly by the employer."

Applying that definition to the submitted schedules of premiums to be charged to smokers and nonsmokers, we conclude that neither the smokers' coverage nor the nonsmokers' coverage is "carried directly or indirectly by the employer" for purposes of section 79 of the Code. Accordingly, only the group term life insurance provided through the Company's basic policy will be subject to the inclusion rules of section 79.

Insurance Coverage on the Lives of Spouses and Children

Section 61(a)(1) of the Code generally provides that gross income means all income from whatever source derived, including compensation for services, fees, commissions, fringe benefits and similar items. Treas. Reg. § 1.61-21(a)(3) provides that a fringe benefit provided in connection with the performance of services shall be

considered to have been provided as compensation for such services. In general, an employee must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of (i) the amount, if any, paid for the benefit by or on behalf of the recipient, and (ii) the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Code. Treas. Reg. § 1.61-21(b)(1). The fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's length transaction. Treas. Reg. § 1.61-21(b)(2).

Special rules apply when the fringe benefit provided to the employee is group term life insurance. For group term life insurance on the life of an individual other than an employee (such as the spouse or dependent of the employee) provided in connection with the performance of services by the employee, section 1.61-1(d)(2)(ii)(b) of the regulations states that the "cost" of the insurance is includible in the gross income of the employee. The "cost" of dependent group term life insurance must be determined under Table I of section 1.79-3(d)(2) of the regulations. The uniform premium rates in Table I are based on average costs for employer-provided group life insurance. However, the cost of employer-provided dependent group term life insurance is not includible in gross income to the extent such cost is paid by the employee on an after-tax basis. Thus, the amount includible in income is the cost (as determined under Table I) less the amount paid for the insurance by the employee. Nothing is includible, however, if such amount is "de minimis". See Notice 89-110, 1989-2 C.B. 447.

The taxpayer asserts that the specific rule provided in Treas. Reg. § 1.61-2(d)(2)(ii)(b) that governs the tax treatment of dependent group term life insurance does not apply to the spousal insurance coverage provided under Company's plan. The taxpayer asserts that, because the spousal insurance coverage does not satisfy the requirement in section 79 that the policy be "carried directly or indirectly by the employer", it does not constitute "group term life insurance" within the meaning of Treas. Reg. § 1.79-0. Because the specific rule in Treas. Reg. § 1.61-1(d)(2)(ii)(b) expressly applies to "group term life insurance", and the spousal coverage is not group-term life insurance, the taxpayer contends that the more general rule at Treas. Reg. § 1.61-21(b)(1) applies, requiring that an employee include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of (i) the amount, if any, paid for the benefit by or on behalf of the recipient, and (ii) the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Code. Insofar as the employees pay fair market value for the spousal insurance coverage, the taxpayer asserts that such coverage results in no income to the employees.

We disagree with the taxpayer's assertion that the spousal coverage does not constitute "group term life insurance" because it fails to satisfy the requirement in section 79 that the insurance be "carried directly or indirectly by the employer." We

conclude that the phrase "group term life insurance," as used in Treas. Reg. § 1.61-2(d)(2)(ii)(b), should be interpreted in accordance with its plain meaning, i.e., term insurance provided to a group. The spousal coverage is clearly term insurance, and the taxpayer concedes that it is provided to Company's employees (a "group") by virtue of their employment relationship. We base our conclusion on the legislative history of I.R.C. § 79, and on the fact that the section 79 regulations expressly state that the provisions in section 79 apply only for purposes of section 79.

Prior to enactment of section 79, Treasury regulations provided that an employee was not required to include in income the cost of group term life insurance provided by an employer on the employee's life. The Treasury's administrative position was apparently grounded on a combination of policy factors such as encouragement of the socially desirable group protection of a deceased employee's family, and the fact that such protection was not usually very extensive or expensive. See Enright v. Commissioner, 56 T.C. 1261 (1971). In enacting section 79, Congress in effect revoked the prior administrative exclusion of this type of compensation beyond the cost of $50,000 protection, while at the same time providing a precise statutory exclusion for such cost, up to that amount. The enactment of section 79 was not intended to affect the taxation of other types of insurance provided to employees by their employers. H. Rept. No. 744, 88th Cong., 1st Sess. (1963), 1964-1 C.B. (Part 2) 277, 278. Unless excluded by section 79, all other variations from employee group-term life insurance are to be treated for what they are – compensation within the meaning of section 61. Enright, supra, at p. 1268.

Thus, the purpose of section 79 was not to define group term life insurance. Instead, section 79 was enacted to carve out a limited exclusion for a specific type and amount of group term life insurance that is not subject to taxation, while at the same time clarifying that all other group term life insurance not meeting the requirements of section 79 is to be included in compensation.

Moreover, the application of the provisions in section 79 and its implementing regulations is expressly limited for purposes of section 79 and the section 79 regulations only. For example, Treas. Reg. §1.79-0 states that the definitions in that section, including the definition of "carried directly or indirectly by the employer," apply for purposes of "section 79, this section, and sections 1.79-1, 1.79-2, and 1.79-3." Similarly, section 1.79-1(a), which states the general requirements for group term life insurance, provides that "[l]ife insurance is not group-term life insurance **for purposes of section 79** unless it meets the following conditions..." (emphasis added). Finally, section 1.79-3(g)(2) expressly provides: "An amount equal to the cost of group-term life insurance on the life of the spouse or other family member of the employee which is provided under a policy of group-term life insurance carried directly or indirectly by his employer is not subject to the provisions of section 79 since it is not on the life of the employee. See paragraph (d)(2)(ii)(b) of § 1.61-2 for rules regarding the tax treatment of such insurance." See also, Treas. Reg. § 1.79-1(f)(2) (providing that section 61(a)

and the regulations thereunder provide rules relating to life insurance not meeting the requirements of section 79 because it is on the life of a non-employee, such as an employee's spouse).

Accordingly, we conclude that Treas. Reg. § 1.61-2(d)(2)(ii)(b) applies to Company's spousal insurance coverage such that an employee purchasing such insurance must include in income an amount equal to the difference between the "cost" of the spousal coverage (as determined under Treas. Reg. § 1.79-3(d)(2)), and the amount paid by the employee for the insurance.

The taxpayer also requests a ruling that the group term life insurance provided to employees on the lives of their children and paid for entirely by the employees does not result in income to the employees under Treas. Reg. § 1.61-2(d)(2)(ii)(b) or is excludable as a de minimis fringe benefit under section 132(e).[1] The premium rate for coverage in the face amount of $10,000 per child, paid entirely by the employees, is a flat rate regardless of the number of children. Some employees with fewer children pay more than the uniform rates in Table I of Treas. Reg. § 1.79-3(d)(2), and some employees with more children pay less than the uniform rates. As set forth below, those employees who pay more than the uniform rates in Table I of Treas. Reg. § 1.79-3(d)(2) will have no income. However, for those employees who pay less than the uniform rates, we decline to issue a broad ruling on whether the insurance coverage qualifies as a de minimis fringe, as this is essentially an issue of fact, and the value of the dependent coverage received will be different for each individual employee, depending on the number of children covered. However, we offer the following guidance on how the taxpayer can determine whether the coverage will result in income to its employees.

Section 132(e) of the Code defines the term "de minimis fringe" as any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable. Generally, the frequency with which similar fringes are provided by the employer to the employer's employees is determined by reference to the frequency with which the employer provides the fringes to each individual employee. Treas. Reg. §1.132-6(b).

Pursuant to Notice 89-110, 1989-2 C.B. 447, if the face amount of employer-provided group term life insurance payable on the death of a spouse or dependent of an employee does not exceed $2,000, such insurance shall be deemed to be a de

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[1]Treas. Reg. §1.132-6(e)(2) provides that the cost of employer-provided group term life insurance on the life of the spouse or dependent of an employee is not excludible from gross income as a de minimis fringe. However, the effective date of this provision as it relates to such insurance has been postponed until further notice.

minimis fringe benefit under section 132(e). In determining whether employer-provided dependent group term life insurance with a higher face amount is a de minimis fringe benefit, only the excess (if any) of the cost of such insurance over the amount paid for the insurance by the employee on an after-tax basis shall be taken into account. The cost of the insurance shall be determined under Treas. Reg. §1.79-3(d)(2).

In the instant case, the dependent coverage has a face amount of $10,000 per child. The employees all pay the same flat rate for such coverage, regardless of the number of children covered. Inasmuch as the amount of the insurance exceeds $2,000, in determining whether the dependent coverage is a de minimis fringe benefit, the taxpayer must consider the excess (if any) of the cost of such insurance to each employee over the amount paid for the insurance by each employee on an after-tax basis. Using this approach, those employees who pay more than the cost of the uniform rates in Table I of Treas. Reg. §1.79-3(d)(2) will have no income.

RULINGS

1. Company may elect, for purposes of section 79 of the Code, to treat the group term life insurance provided to its employees under its basic policy as a separate policy from its supplemental policy.

2. Company may elect, for purposes of section 79 of the Code, to treat the life insurance offered to its smoking employees as a separate policy from the insurance offered to its nonsmoking employees. As a result, no income will be imputed to the Company's employees because of the supplemental coverage.

3. The difference between the “cost” of the spousal coverage (as determined under Treas. Reg. §1.79-3(d)(2)) and the amount paid by an employee for the insurance is includible in the employee’s gross income.

4. In determining whether the dependent coverage is a de minimis fringe benefit, the taxpayer must consider the excess (if any) of the cost of such insurance to each employee over the amount paid for the insurance by each employee on an after-tax basis.

No ruling has been requested and no opinion is expressed as to whether the Company's basic coverage qualifies under section 79 of the Code. Moreover, no opinion is expressed as to the tax treatment of the transaction under the provisions of any other section of the Code, or to the tax effects resulting from the transaction which are not specifically covered by the above rulings.

A copy of this letter should be attached to the Company's next federal income tax return. A copy is provided for that purpose.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

James L. Brokaw
Chief, Exempt Organizations Branch 1
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:
Copy for section 6110 purposes
Copy of this letter