Tax & Business Alert – October 2024

Word count target: 320-340

Actual:

Abstract: Employer-provided life insurance can be a great benefit, with the cost partially excluded from an employee's taxable income. Participating employees need to be aware that this exclusion only applies to the first $50,000 in coverage, and the employer-paid cost of the excess will be reported on the employee's Form W-2. This is true even if the life insurance benefits are never received.

When is employer-provided life insurance taxable?

If the fringe benefits of your job include employer-paid group term life insurance, a portion of the premiums for the coverage may be taxable. And that could result in undesirable income tax consequences for you.

The cost of the first $50,000 of group term life insurance paid by your employer is excluded from taxable income. But the employer-paid cost of that coverage over $50,000 is taxable to you and included in the taxable wages reported on your Form W-2, even if you never actually receive any benefits from it. That's called "phantom income."

Have you reviewed your W-2?

If you think the tax cost to you of employer-provided group term life insurance is too high, you can check your W-2. If there's a dollar amount in Box 12 (with code "C"), that's the amount your employer paid to provide you with group term life insurance over $50,000, minus any amount that you paid for the coverage. You're responsible for any taxes due on the amount in Box 12, including employment tax.

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. It's the amount in Box 1 that's reported on your tax return.

What are your options?

If the tax cost seems too high for the benefit you're getting, ask your employer if they have a "carve-out" plan, which allows certain employees to opt out of the group coverage. If there's no such option, ask your employer if they'd be willing to create one.

Carve-out plans vary, but one option is for the employer to continue to provide $50,000 of coverage at no cost to you. The employer could then either provide you with an individual policy for the balance of the coverage, or a cash bonus representing the amount the employer would've spent for the excess coverage. You can then use that money to pay premiums for an individual policy.

We can help

You may have other questions about your group term life insurance benefit. Feel free to contact us for answers.