

Carving out life insurance benefits for employees

Traditionally, group-term life insurance coverage is a popular fringe benefit for employees. For example, each employee may be covered for three or four times his or her annual salary. The company may foot the entire bill or require employees to kick in contributions. Either way, since the cost is determined by **group rates**, the premiums are generally quite reasonable.

Basic Tax Benefit: Assuming the plan is properly structured, the first \$50,000 of coverage is tax-free to an employee. However, the value of any excess coverage is subject to federal income tax. The amount of taxable income is figured under a special government table.

The older you are, the higher the value for income tax purposes.

Hypothetical Example: Ebenezer Smith and Florence Jones, the two principals of Eb & Flo, Inc., are 45 years old and 55 years old, respectively. Each one receives \$300,000 of group-term insurance coverage from the company plan and neither contributes to the cost. Result: the excess coverage above \$50,000 results in annual income of \$450 to Smith and \$1,290 to Jones.

The taxable amount increase even more drastically for older employees. For example, a 65-year-old who receives \$300,000 of coverage would be charged with taxable income of \$3,810. Note: these amounts are reduced by **employee contributions** to the cost of coverage.

Other Factors: Aside from the tax cost of group-term life insurance, another consideration is that coverage may be lost when an employee retires or quits. And, of course, group-term coverage provides death benefits only. It has no cash value.

Accordingly, some employees would be better served by a policy with permanent cash-value life insurance protection. In addition, employees could take advantage of a growing cash equity. The funds may be tapped for college costs, buying a home, starting a business or some other worthwhile purpose.

In view of this, some companies are converting their group-term plans to group carve-out plans. **How It Works:** The funds that go toward group-term coverage in excess of \$50,000 are "carved out" and paid to employees as bonuses or credits. The employees use these bonuses or credits to buy permanent life insurance.

Result: Besides the benefits already indicated, employees are able to maintain their permanent insurance after retirement. Furthermore, since group-term coverage is limited to \$50,000, there is no additional taxable income. Of course, employees are taxed on the bonuses or credits.

A group plan can make it easier for a company to attract and retain valuable employees at a relatively low cost. With the proper planning, your company can adopt the type of plan that best fits its needs.