CHAPTER 3. LIFE INSURANCE

3-1. DEFINITION. As used herein, "life insurance" means the form of death benefit provided through an individual or group policy of term or permanent insurance. The following forms of death benefits generally are not considered to be life insurance: refunds of employee and HA contributions paid into a retirement plan; the cash surrender value of retirement annuity policies; proceeds from an accidental death and dismemberment policy; and incidental lump-sum payments primarily intended for settlement of expenses for final illness and burial.

3-2. FORMS OF LIFE INSURANCE. Life insurance coverage may be provided under any of the five sub-classifications listed below. Generally, more than one sub-classification may be used to provide such benefits. The level of insurance is usually rounded to the next higher $1,000. The plan may presume that mandatory employee contributions, if any, will first be applied to pay all applicable life insurance premiums.

a. Independent Term Insurance.

b. Term Insurance as Part of a Retirement or Other Benefit Plan.

c. Permanent Whole Life Insurance as Part of a Retirement Plan. IRS regulations provide that no more than 49 percent contribution to a contributory plan may be used to pay the premiums on such coverage.

d. Retirement Income Insurance Contract as Part of a Retirement Plan. A retirement income contract is one which provides a death benefit of $1,000, or the reserve, if greater, for each $10 per month of guaranteed life annuity at normal retirement. IRS regulations provide that at least 25 percent of the contributions must be applied to the purchase of these coverages.

e. Universal Life Insurance as Part of a Retirement Plan. Group universal life insurance, which combines group term life insurance with a cash accumulation feature, is made available to employees by an employer who is issued a master policy; employees receive certificates as evidence of coverage and pay the entire premium. For plans using individual universal life insurance policies, IRS regulations provide that no more than 25 percent of the contributions may be used to pay the premiums on such coverage.

3-3. TAXATION ON LIFE INSURANCE PREMIUMS. It should be noted that the taxation on employees for a given amount of life insurance depends on which of the above insurance coverages is provided. If insurance is provided as part of the retirement plan, the full amount of the imputed premium will be considered income to the employee and subject to income tax. The amount of the imputed premium will be based upon the lesser of IRS rates (the so-called "PS 58"rates) or the insurance company's individual one-year term policy rates available to all standard risks. If coverage is provided through independent group term insurance, there will be no imputed income to the employee with respect to premiums paid to cover the first $50,000; the employee will have to pay income tax on the imputed premium on the coverage in excess of $50,000. The amount of this imputed income is based upon IRS "Table 1" rates (IRC Sec. 79).

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