

PY-04 Imputed Income for Term Life Insurance FAQs

Purpose

The purpose of this job aid is to answer frequently asked questions (FAQs) about imputed income for term life insurance.

Payroll-Benefits Related Information

Formula for the calculation of the imputed income amount.

What is imputed income?

The IRS requires you to be taxed on the value of employer-provided group term life insurance over \$50,000. The taxable value of this life insurance coverage is called “imputed income.” Even though you don't receive cash, you are taxed as if you received cash in an amount equal to the value of this coverage.

Why is pre-tax Term Life insurance subject to the imputed income rules?

Because your monthly premium for group term life insurance coverage is deducted from your pay on a pre-tax basis, the IRS considers it to be “employer provided.” Therefore, the value of any pre-tax (and other employer-provided) coverage over \$50,000 is added to your taxable compensation as “imputed income.”

What am I paying tax on?

The Retirement System death benefit and the NC Flex group term life insurance benefit are added together. The amount which can be provided tax-free (\$50,000) is subtracted from this amount. You pay taxes on the amount of

term life coverage over \$50,000. You can estimate your imputed income, which is subject to taxation, by using the Imputed Income Calculator.

What happens if I am not yet eligible for the Retirement System death benefit because I do not have one year of service under the Retirement System?

Once you become eligible for the Retirement System death benefit, that benefit will be added to your total term life benefit when calculating the amount of your imputed income. Until then, only your NC Flex group term life benefit will be included in this calculation. (For example, if you are not yet eligible for the Retirement System death benefit and your NC Flex group term life benefit is less than \$50,000, you will not have any imputed income.)

When am I taxed?

Your pre-tax premium deduction for the term life benefit comes out of your check each payday. Also, any taxable imputed income resulting from your "employer-provided" pre-tax coverage is added back at the same time. Generally, however, many employees will experience a "tax wash." This means the savings employees would receive by purchasing their term life insurance coverage on a pre-tax basis is roughly the same amount of tax on the imputed income added to their pay.

Am I being taxed twice?

No. Imputed income is taxed once and that is each payday. At the end of the year, your Form W-2 will include your taxable income (including imputed income) as well as the amount of taxes that have been taken out throughout the year.

Why am I taxed for a death benefit that I may never use?

Since the State provides this benefit to you (rather than you having to pay for it on your own) the IRS treats it as taxable income just like your pay.

What is the long-term effect on my retirement benefit?

Participation in the term life plan will not affect your benefit under the Retirement System. In addition, it will not affect the amount you may contribute to the State's 401(k) plan or to a 403(b) or 457 retirement plan.

Plan participation may affect your future Social Security retirement benefits. This could happen if your taxable pay (after pre-tax contributions are taken out) is below the Social Security taxable wage.

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