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September 28, 2000

Legend

X =  
State =  
statute a =  
Y =

Dear

This letter is in response to a request submitted on behalf of X by its authorized representatives for rulings concerning group term life insurance provided to State and local government employees.

X, an independent agency of State, is administered by a Board of Trustees (the "Board"). Pursuant to statute a, the Board has been given the authority and responsibility by the state legislature to make group term life insurance available to state employees, teachers, certain employees of political subdivisions and certain other employees. Basic life insurance protection on the life of the employee is provided to each eligible employee by the Board and is paid for by a combination of employee and employer contributions.

The Board also makes available to each active eligible employee optional life insurance on the life of the employee. The full cost of the optional insurance selected by the employee is borne by the employee and withheld from his or her salary on an after-tax basis.

Both the basic and the optional insurance coverage are purchased through Y, a life insurance company. X and Y represent that the premium rates for the optional insurance are determined separately and independently of the premium rates for the basic life insurance. The finances of the optional and basic insurance plans are accounted for separately and independently. The optional insurance does not subsidize the basic insurance, nor does the basic insurance subsidize the optional insurance.

LAW AND ANALYSIS

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

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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 of §1.79-3(d)(2), and at least one other employee more than the cost of his or her insurance, determined in the same way.

Applying the above rules to the group term life insurance on the lives of employees available through X, both the basic and the optional insurance are available

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to the eligible employees because of the employment relationship. In addition, both the basic and the optional insurance are purchased from the same insurer. Therefore, the obligations contained in the basic and the optional coverage will be treated as a single "policy" for purposes of section 79, unless the requirements have been met to elect to treat such obligations as separate policies. Because neither the basic nor the optional coverage contains permanent benefits, the only requirement for electing separate treatment is that the premiums be properly allocated between the basic and the optional coverages.

Based on the representations made, we conclude that the insurance premiums are properly allocated between the basic coverage and optional coverage so that an election can be made to treat the basic and the optional coverage as separate policies for purposes of section 79 of the Code. Because the employer pays part of the cost of the basic insurance coverage, we conclude that the basic coverage is within the definition of "carried directly or indirectly by the employer."

We further conclude that because the premiums for the optional coverage are not financed by the employer and do not "straddle" the Table I rates, the optional coverage is not "carried directly or indirectly by the employer" for purposes of section 79 of the Code.

#### RULINGS

1. X may elect, for purposes of section 79 of the Code, to treat the basic group term life insurance coverage as a separate policy from the optional coverage.
2. If the Board elects to treat the optional life insurance coverage on the lives of the employees as a separate policy, no income will be imputed under section 79 of the Code to those employees who purchase the optional life insurance.

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.

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)

Enclosure:

Copy for section 6110 purposes  
cc: