INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Number: **200502040**
Release Date: 01/14/2005
Index (UIL) No.: 61.53-00, 79.03-00, 83.05-00
CASE-MIS No.: TAM-144621-03

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:

LEGEND:

Taxpayer =

U =

A =

Group Universal Life Fund =

ISSUES:

(1) Are amounts includible in the gross income of an employee as a result of a group universal life insurance program offered to the employees of the Taxpayer?

(2) Are amounts includible in the gross income of an employee as a result of a dependent group life insurance program offered to employees of the Taxpayer?

CONCLUSION:

(1) Amounts are not includible in the gross income of any employee of the Taxpayer as a result of the group universal life insurance program described in this memorandum that is offered to the employees through the Taxpayer.

(2) Amounts may be includible in the gross income of one or more employees of the Taxpayer as a result of the dependent group life insurance program described in this memorandum that is offered to the employees through the Taxpayer.

FACTS:

Taxpayer is a corporation employing a large number of employees. During the years involved, Taxpayer offered to eligible employees basic group term life insurance on the life of the employee (Basic Life) in an amount equal to twice the employee's pay. Basic Life was insured by Insurance Company, U, and was administered by U. Each employee electing to enroll in the Basic Life plan contributed 15 cents per $1,000 of coverage each month, and Taxpayer paid the remaining cost.

For the years involved, all of Taxpayer's active employees enrolled in the Basic Life program were eligible to apply for supplemental life insurance on the life of the employee through a group universal life (Group Universal) program. The Group Universal program was administered by A and insured by Insurance Company U. Employees desiring to enroll in the program applied directly to A. The premium amounts were deducted from the employee's paycheck each month. All amounts were paid for entirely by the employees on an after-tax basis. Materials provided to its employees stated that the Group Universal program is not a plan sponsored by the Taxpayer. According to the Taxpayer, its involvement in the Group Universal program was limited to distributing information provided by A about the program and providing a payroll deduction for employees who elected the Group Universal coverage and remitting those amounts to A.

Materials provided to its employees by the Taxpayer summarizing the employees' various life insurance benefits divided the Group Universal into two parts: Group Universal Life Insurance and Group Universal Life Fund. The coverage available under the benefit described as Group Universal Life Insurance was, in general, one to eight times annual pay. The premiums charged for the Group Universal Life Insurance were based on $1,000 of coverage and were age-related, automatically adjusted each year based on the employee's age on January 1. Rates charged to the employees for the coverage could be changed annually to reflect the experience of the group. Taxpayer has submitted a schedule of the premiums charged for the years involved. An employee enrolled in the Group Universal program could have Taxpayer deduct additional payroll amounts to be directed to a Group Universal Life Fund. Amounts equal to from one to five times the premiums paid by the employee for the Group Universal Life Insurance coverage could be contributed to the Group Universal Life Insurance Fund. Amounts contributed to the Fund earned interest. The amounts in an employee's Fund could be used by the employee toward the payment of the next policy premium or to purchase paid-up life insurance, or were available for loans or cash withdrawals. At death, any balance of the employee's Fund was payable to the employee's named beneficiary. An employee who retired or otherwise terminated employment could elect to continue in the Group Universal program and would share in the experience pool of Taxpayer's employees and pay the premium rates of Taxpayer's employees, although generally a monthly administrative fee would also apply.

Employees enrolled in the Group Universal program were issued a certificate from U describing the benefits and stating that benefits were subject to the terms and conditions of the Group Policy issued for the Group Universal program for the employees of Taxpayer. According to U, the group universal life insurance policy, including the Fund as a component thereof, was a single, integrated, permanent insurance policy, which had been filed with and approved by state insurance regulators as a single life insurance policy form. The cash value feature of the insurance contract was referred to as the Fund.

U sells group universal policies similar to that provided under the Group Universal program for Taxpayer's employees on the same terms and in substantial amounts to individuals who do not purchase (and whose employers do not purchase) any other obligation from U. For those Group Universal policies issued to employers that do purchase other products from U, the revenues or profits under the other products do not enter into setting rates under the Group Universal coverage in any way. In particular for Taxpayer, the experience rating calculation was done separately for the Group Universal and the Basic Life. U has submitted information explaining how the premiums rates, dividends, and other factors were developed separately for each policy.

For the years involved, the coverage provided under the Basic Life and that provided under the Group Universal were not treated as a single policy for purposes of section 79 of the Internal Revenue Code.

During the years involved, Taxpayer also offered eligible employees dependent group life insurance (DGLI) covering the lives of the employee's spouse and eligible dependent children. Employees could purchase DGLI at one of three levels, described in the following chart:

Cost Per Month	Coverage for Spouse	Coverage for Each Child – regardless of #
$3.00	$15,000	$5,000
$6.00	$30,000	$5,000
$9.00	$45,000	$5,000

Taxpayer contracted with U to provide the DGLI. Only employees of Taxpayer could purchase the DGLI. The employee paid the full premium for DGLI coverage on an after-tax basis. Taxpayer paid no portion of the premiums associated with this coverage, and the premiums charged under the DGLI coverage were not subsidized by the premiums charged on any other insurance provided to Taxpayer's employees.

Termination of coverage for eligible dependents under DGLI would cease upon the last day of the month of the employee's death, the last day of the month the dependent no longer qualifies as a dependent, or upon termination, cancellation or transfer.

If an employee did not enroll within 31 days following employment, marriage, or the birth/adoption of a child, the insured party had to furnish evidence of good health prior to enrollment.

LAW AND ANALYSIS:

<u>Group Universal Program</u>

Section 79 of the Code generally provides that an employee (including a former employee) must include in gross income an amount equal to the cost of group-term life insurance on his or her life provided under a policy (or policies) carried directly or indirectly by his or her employer, but only to the extent that the cost exceeds the sum of (1) the cost of $50,000 of coverage, and (2) the amount (if any) paid by the employee toward the purchase of such insurance. The cost of the insurance is computed by using the uniform premiums (computed on the basis of 5-year age brackets) prescribed in Table I of the section 79 of the regulations.

Section 1.79-1(a) of the regulations provides that life insurance is not group-term life insurance for purposes of section 79 of the Code unless it meets the following conditions:

(1) It provides a general death benefit that is excludable from gross income under section 101(a).

(2) It is provided to a group of employees.

(3) It is provided under a policy carried directly or indirectly by the employer.

(4) The amount of insurance provided to each employee is computed under a formula that precludes individual selection. In general, this condition may be satisfied even if the amount of insurance provided is determined under a limited number of alternative schedules that are based on the amount each employee elects to contribute.

Section 1.79-1(b) of the regulations provides that no part of the life insurance provided under a policy that provides a permanent benefit is group-term life insurance unless (1) the policy or the employer designates in writing the part of the death benefit provided to each employee that is group-term life insurance, and (2) the part of the death benefit that is provided to an employee and designated as the group-term life insurance benefit for any policy year is not less than the difference between the total death benefit provided under the policy and the employee's deemed death at the end of the policy year determined under section 1.79(d)(3).

Section 1.79-1(d)(1) of the regulations provides that if an insurance policy that meets the requirements of section 1.79-1 provides permanent benefits to an employee, the cost of the permanent benefits reduced by the amount paid for permanent benefits by the employee is included in the employee's income. The cost of the permanent benefits for this purpose is, at minimum, an amount determined under a formula set out in section 1.79-1(d)(2).

Section 1.79-3 of the regulations provides that for determining the amount to be included in an employee's gross income under section 79(a) of the Code, the cost of the group-term life insurance on the employee's life to be taken into account is calculated, then reduced by the amount paid by the employee toward the purchase of group-term life insurance. The group-term life insurance to be taken into account for this purpose is the sum of the proceeds payable upon the death of the employee under each policy, or portion of a policy, of group-term life insurance to which the rule of inclusion set forth in section 79(a) applies, less $50,000 of such insurance.

Section 1.79-0 of the regulations generally defines a "permanent benefit" as an economic value extending beyond one policy year (for example, a paid-up or cash surrender value) that is provided under a life insurance policy.

Section 1.79-0 of the regulations provides that 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. The actuarial sufficiency of the premiums charged for each obligation is not taken into account in determining whether the obligations are sold in conjunction. In addition, obligations may be sold in conjunction even if the obligations are contained in separate documents, each document is filed with and approved by the applicable state insurance commission, or each obligation is independent of any other obligation. Similarly, two benefits provided to a group of employees, one term life insurance and the other a permanent benefit, may be a policy, even if one of the benefits is provided only to employees who decline the other benefit. However, an employer may 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. An employer may also elect to treat an obligation that provides permanent benefits as separate policy if --

(1) The insurer sells the obligation directly to the employee who pays the full cost thereof;

(2) The participation of the employer with respect to the sales of the obligation to employees is limited to selection of the insurer and the type of coverage and to sales assistance activities such as providing employee lists to the insurer, permitting the insurer to use the employer’s promises for solicitation, and collecting premiums through payroll deduction;

(3) The insurer sells the obligation on the same terms and in substantial amounts to individuals who do not purchase (and whose employers do not purchase) any other obligation from the insurer; and

(4) No employer-provided benefit is conditioned on purchase of the obligation.

Section 1.79-0 of the regulations provides that 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 section 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.

The legislative history of section 79 of the Code states that the cost of group-term life insurance protection above the exclusion level is to be taxed to an employee “if it is provided under a plan arranged for by the employer whether the protection the employee receives (over and above that provided by his own contributions) is provided directly by the employer, or indirectly by the employer’s charging more than the cost of the insurance to other employees (such as those in younger age brackets) and less to those in the older age brackets, such as the specific employee in question.” S. Rep. No. 830, 88th Cong., 2d Sess. 1 (1964), 1964-1 (Part 2) C.B. 502, 550.

Section 83 of the Code provides rules governing the taxation of property transferred in connection with the performance of services. Generally, upon the transfer of substantially vested property to a service provider, the service provider must recognize income under section 83(a) in amount equal to the excess of the fair market value of the property over the amount the service provider paid for the property. Section 1.83-3(e) defines property in the case of a transfer of a life insurance contract or other contract providing life insurance protection as only the cash surrender value of the contract. Section 83(e)(5) of the Code provides that section 83 does not apply to group-term life insurance to which section 79 applies.

Applying the above rules to the insurance provided to employees of Taxpayer, each policy (within the meaning of that term in section 1.79-0 of the regulations) of life insurance on the lives of the employees must be tested separately to determine whether the benefits provided to an employee are subject to the exclusion and inclusion provisions of section 79 and the regulations. The regulations provide that unless an obligation can be treated as a separate policy, a policy includes two or more obligations of an insurer that are offered or available to members of a group of employees because of the employment relationship. While the regulations do not define "obligation," it is clear from the term's use in the regulations that it is not synonymous with the term "policy" as it is used for State regulatory purposes, and that it does not refer to the document containing the terms of the agreement. We conclude that the Basic Life Insurance available to employees of Taxpayer is an "obligation" within the meaning of section 1.79-0 of the regulations. Further, we conclude that the portion of the Group Universal program that provided Group Universal Life Insurance to Taxpayer's employees is an "obligation" within the meaning of the regulations, and that the Group Universal Life Fund portion of the Group Universal program is also an "obligation." Since all three are obligations of U and all are offered or available to Taxpayer's employees because of the employment relationship, they will be tested as one policy under the rules of section 79 unless Taxpayer can elect to treat them as separate policies. If all the obligations are treated as one policy, the cost of the term protection provided by the Basic Life Insurance and that provided by the Group Universal Life Insurance must be aggregated in determining the amount includible in an employee's income. Further, if the permanent benefits provided under the Group Universal Life Fund portion of the Group Universal program cannot be treated as a separate policy, the cost of the permanent benefits (as determined under section 1.79-1(d)(2) of the regulations), less amounts paid by an employee for those benefits, are includible in the gross income of one or more employees.

An employer may treat two or more obligations, each of which provides no permanent benefits, as separate policies if the premiums are properly allocated among such policies. Neither the Basic Life nor the Group Universal Life Insurance (the portion of the group universal program that does not include the Fund component) provided permanent benefits. We conclude from the information provided by Taxpayer and U that the premiums were properly allocated between these two obligations so that the Group Universal Life Insurance can be tested as a separate policy for purposes of determining whether the insurance is group-term life insurance for purposes of section 79 of the Code, and as determined under section 1.79-1(a) and -1(b) of the regulations. We conclude that the coverage provided by the Group Universal Life Insurance meets the conditions described in sections 1.79-1(a)(1), (a)(3), (a)(4) and -1(b). With respect to section 1.79(a)(2), pursuant to section 1.79-0, even though Taxpayer has not paid any of the cost of the Group Universal Insurance, the insurance coverage will be treated as carried directly or indirectly by the employer if Taxpayer (a) arranged for payment of the cost of the life insurance by their employees, and (b) charged at least one employee less than the cost of his or her insurance (as determined under Table I) and at least one other employee more than the cost of his or her insurance. The premium amounts for the insurance were paid through payroll deductions and taxpayer remitted those amounts to the administrator of the program. Thus, we conclude that the Taxpayer has "arranged for payment" of the insurance within the meaning of section 1.79-0 of the regulations. However, the premiums charged to the employees for the Group Universal Life Insurance portion of the Group Universal program did not "straddle" the Table I rates.1 Accordingly, we conclude that the Group Universal Insurance was not provided under a policy "carried directly or indirectly" by the employer so that, by Taxpayer electing to treat the Group Universal Life Insurance as a separate policy, the coverage provided under that portion of the Group Universal program is not subject to the taxation rules of section 79.

With respect to whether the permanent benefits provided under the Group Universal Life Fund are subject to taxation under section 79 of the Code, an obligation that provides a permanent benefit can be treated as a separate policy if the four requirements described in the regulations are met. Those requirements were intended to ensure that premiums paid on a policy that is fully or partially financed by an employer can be properly allocated between the group-term coverage and the permanent benefits in those situations where amounts are either includible or excludable under section 79 as a result of the group-term coverage provided under the policy. Three of those requirements have been met in this case: the insurer sold the obligation directly to the employee who paid fully for its cost; the participation of the employer was limited as required; and no employer-provided benefit was conditioned on purchase of the obligation. However, there is no indication that the insurer sold the obligation represented by the Fund itself on the same terms and in substantial amounts to individuals who do not purchase (and whose employers do not purchase) any other obligation from the insurer. Even so, we have found no indication that either the statute or the regulations were intended to require an employee to include amounts in income for the cost of permanent benefits where the employer (or another employee) is not financing the provision of the permanent benefits, where the premium amounts for the permanent benefits aren't being allocated in a way that would reduce amounts includible under section 79 for the group-term obligation2, and where the employer's involvement is otherwise so limited as it is here. Thus, for purposes of this TAM, we conclude that Taxpayer can treat the Group Universal Life Fund as a separate policy.

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1 Effective until January 1, 2003, §1.79-3(e)(2) of the regulations allowed an employer to use the Table I as in effect before July 1, 1999, to determine whether the premiums charged under the policy straddle Table I rates. (Prior to determining that the premiums charged for the Group Universal Life Insurance did not straddle the Table I rates, we determined that the premiums charged were properly allocable to the group-term life insurance portion of the Group Universal program, rather than the Fund, as evidenced by the fact that employees were charged this amount for the Group Universal Life Insurance coverage whether or not they elected to participate in the Fund portion of the program.)

2 From the information submitted by Taxpayer and U, we have concluded that the amounts charged for, and allocated to permanent benefits provided under the Group Universal Life Fund, are not being used to reduce amounts includible in income under the Basic Life program.

As a separate policy, the Fund does not meet all the elements of sections 1.79-1(a) and (b) of the regulations, so that no income is includible in any employee’s income under section 79 for the cost of the permanent benefits.

By treating the obligations separately so that section 79 of the Code applies to neither the Group Universal Life Insurance nor the Group Universal Life Fund portions of the Group Universal program, the issue arises as to whether section 83 may apply. However, this need not be decided because under the facts of this case any property transferred would have been substantially vested at the time of transfer, and the fair market value of the property would not have exceeded the amount paid by the employee for the property. Accordingly, even if section 83 were applicable, there would be no potential for income recognition under section 83. Further, no amounts are includible in any employee's income under section 61 as a result of the Group Universal Life program being offered through the employer.

Dependent Group Life Insurance Program

Section 61(a)(1) of the Code generally provides that gross income means all income from whatever source derived, including compensation for services, fees, commissions, fringe benefits and similar items.

Section 1.61-21(a)(3) of the regulations provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services. In general, an employee must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of (i) the amount, if any, paid for the benefit by or on behalf of the recipient, and (ii) the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Code. Treas. Reg. § 1.61-21(b)(1). The fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's length transaction. Treas. Reg. § 1.61-21(b)(2).

Special rules apply when the fringe benefit provided to the employee is group-term life insurance. For group-term life insurance on the life of an individual other than an employee (such as the spouse or dependent of the employee) provided in connection with the performance of services by the employee, section 1.61-2(d)(2)(ii)(B) of the regulations states that the "cost" of the insurance is includible in the gross income of the employee. The "cost" of dependent group-term life insurance must be determined under Table I of section 1.79-3(d)(2) of the regulations. The uniform premium rates in Table I are based on average costs for employer-provided group life insurance. However, the cost of employer-provided dependent group term life insurance is not includible in gross income to the extent such cost is paid by the employee on an after-tax basis. Thus, the amount includible in income is the cost (as determined under Table I) less the amount paid for the insurance by the employee. Nothing is includible, however, if such amount is "de minimis." See Notice 89-110, 1989-2 C.B. 447.

Taxpayer makes the following arguments. First, the DGLI is not term insurance subject to section 1.61-2(d)(2)(ii)(B) of the regulations but permanent insurance to be valued under section 1.61-21(b)(2) of the regulations which would result in no income to the employee. Second, the DGLI is not provided in connection with the performance of services and, therefore, is not subject to section 1.61-2(d)(2)(ii)(B) of the regulations. Third, section 1.61-2(d)(2)(ii)(B) of the regulations is invalid under the Administrative Procedures Act because Treasury did not provide any notice or opportunity to comment and, as a result, the DGLI is to be valued under section 1.61-21(b)(2) of the regulations which would result in no income to the employee.

Taxpayer claims that the DGLI is not term insurance within the meaning of section 1.61-2(d)(ii)(B) of the regulations because it was provided to its employees at "level premiums." Taxpayer cites to revenue rulings, an IRS mimeograph, and a general counsel memorandum involving level premium insurance. Taxpayer further contends that because the DGLI is level premium insurance, Table I under the section 79 regulations is an inappropriate measure of the cost of the insurance.

We do not agree with Taxpayer's argument that its DGLI is not term insurance. Taxpayer is confusing premiums that are paid on a level basis over a period of years, the level amount being based on the insured's age at the time of purchase, with certain group life insurance arrangements, such as Taxpayer's DGLI, that charge all employees the same flat premium rate regardless of the age of the insured. An example of the first type of insurance is level premium whole life insurance. Premiums for this type of insurance are determined, in part, by the insured's age at the time the life insurance contract is purchased. The level premiums paid in the early years of the contract will be more than the amount needed to pay the cost of the current death benefit protection for an individual of the insured's age. Those excess amounts will be used in later years to pay a portion of the cost of the death benefit protection when, due to the insured's increased age, the cost is higher than the level premium amount. The excess premiums may also produce a cash value for some of the years.3 In contrast, the DGLI premium amounts charged to Taxpayer's employees are the same for all employees regardless of the age of the employee's spouse (or the number of employee's eligible dependents). Under this type of premium arrangement, any premium amounts paid by an employee during the year that are higher than the cost of current insurance protection for that employee's insured spouse (or dependents) typically are used to subsidize the cost of the insurance for another employee, for which the premium amount charged does not cover the full cost of the insurance for that employee's spouse (or dependents). Unlike level premium whole life, the employee has no right under this type of premium arrangement to have the excess premiums amounts applied to future years.

3 Some term life insurance policies have premium payments that are level for a set number of years, for example for a ten year period. As with level premium whole life, the amount of the level premium depends on the insured's age, and excess amounts in early years are used to supplement premiums in later years.

There is nothing in Taxpayer's materials to show that its DGLI provides any lasting economic benefit in the form of paid up value, cash surrender value, or other value. The only benefit provided to the employee under the contract is in the form of current death benefit protection. Thus, applying normal understanding to the words used in section 1.61-2(d)(ii)(B) of the regulations, the DGLI must be considered term insurance.

Further, we disagree with Taxpayer's argument that section 79's Table I is an inappropriate measure of the cost of the insurance because the DGLI is level premium insurance while Table I rates increase as the insured's age increases (in 5-year increments). It is fundamental that, other factors being equal, an older individual is more likely to die during the year than a younger individual, so that the same amount of life insurance coverage is more valuable when the insured is older than when the insured is younger. Accordingly, for purposes of inclusion of amounts in income it is appropriate that the cost of current insurance protection provided through the DGLI be determined under Table I.

Taxpayer also claims that the DGLI is not provided in connection with the performance of services and therefore is not subject to section 1.61-2(d)(2)(ii)(B) of the regulations. Taxpayer cites two PLRs for the proposition that the DGLI is not provided in connection with the performance of services. We again note that section 6110(k)(3) of the Code provides that PLRs may not be used or cited as precedent. However, we would point out that PLRs 9151033 and 9549029 are distinguishable since they both involved Voluntary Employee Benefit Associations (VEBAs) that were controlled by the employees. In the two VEBA PLRs, the employees in the VEBA decided whether they wanted to offer this type of insurance through the VEBA. The employees contracted and chose the type of insurance. Conversely, in this case, the employer decided whether it wanted to make this type of insurance available to its employees and contracted with the insurance company to provide it. Taxpayer's employees were able to obtain DGLI only by virtue of their employment status with Taxpayer. Indeed, only employees covered by Taxpayer's basic group-term life insurance program were eligible to purchase DGLI. Taxpayer saw fit to add DGLI to their fringe benefit package offered to employees. It is immaterial that the employees have the option to participate in this fringe benefit or not. Therefore, DGLI is provided in connection with services and is subject to section 1.61-2(d)(2)(ii)(B) of the regulations.

Taxpayer also argues that it would be "nonsensical" to treat the phrase "in connection with the performance of services" to mean that if an employer actively arranges for dependent life insurance for its employees then that insurance is subject to section 1.61-2(d)(2)(ii)(B) of the regulations. The taxpayer claims that this regulation requires the inclusion of the cost of dependent life insurance with an express exception for amounts paid by the employee on an after tax basis. The taxpayer cites to Notice 89-110, 1989-2 C.B. 447. We disagree with the taxpayer's interpretation of Notice 89-110. Notice 89-110 states:

> Finally, section 1.61-2(d)(2)(ii)(*b*) of the regulations is clarified to provide that the cost of employer-provided dependent group-term life insurance is not includible in gross income under that section of the regulations (regardless of whether section 132(e) of the Code applies) to the extent such cost is paid by the employee on an after-tax basis. For purposes of this paragraph, the cost of insurance shall be determined under section 1.79-3(d)(2) of the regulations.

A correct interpretation of Notice 89-110 is that it requires inclusion in the employee's income of the difference between the cost of the DGLI and the amount paid by the employee on an after-tax basis, unless the difference can be characterized as a de minimis fringe benefit. Taxpayer's interpretation is incorrect based on the inclusion of, "the cost of insurance shall be determined under section 1.79-3(d)(2) of the regulations." The Service will reduce the amount of gross income as determined by the Table I rates by the amount paid by the employee. Some employees will not have any gross income and others will have gross income and wages.

Taxpayer's third argument is that section 1.61-2(d)(2)(ii)(B) of the regulations is invalid because there was no notice and comment opportunity provided as is required under the Administrative Procedure Act (APA). Taxpayer states the special rule for the taxation of dependent life insurance in section 1.61-2(d)(2)(ii)(B) appeared for the first time in a final rule promulgated in 1966. T.D. 6888. This final rule purportedly was based on a notice of proposed rulemaking issued pursuant to the APA on July 29, 1964. 29 Fed. Reg. 10516. However, the notice of proposed rulemaking reported at 29 Fed. Reg. 10516 did not mention dependent life insurance.

Regulations are presumed to be valid and longstanding regulations have the force of law. T.D. 6888 published in 1966-2 C.B. 23 contains Footnote 1 which states:

> The publication of this Treasury Decision in 31 F.R. 9199, dated July 6, 1966 contains (1) instructions for modifying the notice of proposed rulemaking published in 29 F.R. 10516, dated July 29, 1964, and (2) …. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

While we are unable to locate the individual instructions, we have located a letter from the Commissioner to the Assistant Secretary of the Treasury recommending that regulations found in T.D. 6888 be approved. The letter describes the proposed amendments that were published in 29 F.R. 10516 and oral comments that were received at a hearing held September 10, 1964. The principal changes adopted in the proposed Treasury decision as a result of the comments received included the tax treatment to be accorded group-term life insurance on the life of the spouse or children of an employee. The letter goes on to say that the proposed regulations provided that the cost of the employer provided group-term life insurance on the life of the spouse or children of an employee is not subject to the benefits of the provisions of section 79. In light of the comments by employers and employee representatives who had assumed this type of insurance would be tax free and provided evidence as to the existence of many contracts that included this type of insurance, the proposed Treasury decision included a limited exclusion for the cost of the insurance provided the face amount of the insurance did not exceed $2,000.

We are confident that a court would sustain the validity of the regulation under the APA based on the following factors:

a. The regulation has been in existence almost 40 years,
b. The footnote in 1966-2 C.B. 23, references instructions for modifying the notice of proposed rulemaking,
c. The letter from the Commissioner to the Assistant Secretary of the Treasury explaining that taxpayers were aware of the proposed regulation and that due to their comments there was a change in the regulation, and
d. The cross references in other regulations to section 1.61-2(d)(2)(ii)(B) where taxpayers could make comments concerning section 1.61-2(d)(2)(ii)(B)

As stated above, Taxpayer argues that the DGLI should not be valued under section 1.61-2(d)(2)(ii)(B) but instead should be valued under section 1.61-21(b)(2). While this is incorrect for the reasons already provided, we want to comment on taxpayer's analysis of section 1.61-21(b)(2). Under section 1.61-21(b)(2), the taxpayer asserts that an employee must include in gross income only the amount by which the fair market value of a fringe benefit exceeds the amount the employee pays for the fringe benefit. However, fair market value must be based on an arms length transaction and this does not include the lower cost attributable to provision of a benefit to a particular group. Section 1.61-21(b)(2) states:

> Thus, for example, the effect of any special relationship that may exist between the employer and the employee must be disregarded. Similarly, an employee's subjective perception of the value of a fringe benefit is not relevant to the determination of the fringe benefit's fair market value nor is the cost incurred by the employer determinative of its fair market value.

The taxpayer appears to be applying section 1.61-21(b)(3) of the regulations where the exclusion from income is based on the cost of providing the fringe benefit. However, this applies only if a statutory exclusion exists, for example dependent care assistance programs under section 129 of the Code. Section 1.61-21(b)(3) of the regulations allows that if the fair market value of the dependent care assistance exceeds the employer's cost, the excess is not subject to inclusion. In this case, the cost of insurance provided on an individual basis without requiring a physical and without the benefit of the employer administering the marketing and collection of premiums may be even more expensive than the uniform rates in Table I of section 1.79-3(d)(2).

Lastly, while Taxpayer did not address whether DGLI would qualify as a de minimis fringe benefit, the following analysis is provided.

The premium rate for coverage paid entirely by the employees is a flat rate, regardless of the age of the spouse and regardless of the number of children. Some employees with zero children and younger spouses might pay more than the uniform rates in Table I of section 1.79-3(d)(2) of the regulations, and some employees with many children and older spouses may pay less than the uniform rates. As set forth below, those employees who pay more than the uniform rates in Table I will have no income. However, for those employees who pay less than the uniform rates, we decline to issue a broad ruling on whether the insurance coverage qualifies as a de minimis fringe, as this is essentially an issue of fact, and the value of the dependent coverage received will be different for each individual employee, depending on the number of children covered. However, we offer the following guidance on how Taxpayer can determine whether the coverage will result in income to its employees.

Section 132(e) of the Code defines the term "de minimis fringe" as any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer’s employees) so small as to make accounting for it unreasonable or administratively impracticable. Generally, the frequency with which similar fringes are provided by the employer to the employer’s employees is determined by reference to the frequency with which the employer provides the fringes to each individual employee. Treas. Reg. § 1.132-6(b)(1).

Pursuant to Notice 89-110, 1989-2 C.B. 447, if the face amount of employer provided group-term life insurance payable on the death of a spouse or dependent of an employee does not exceed $2,000, such insurance shall be deemed to be a de minimis fringe benefit under section 132(e) of the Code. In determining whether employer-provided dependent group term life insurance with a higher face amount is a de minimis fringe benefit, only the excess (if any) of the cost of such insurance over the amount paid for the insurance by the employee on an after-tax basis shall be taken into account. The cost of the insurance shall be determined under section 1.79-3(d)(2) of the regulations.

In the instant case, the dependent coverage has a face amount of $ 5,000 per child and either $15,000, $30,000, or $45,000 for spousal coverage. The employees all pay the same flat rate for such coverage, regardless of the number of children or age of the spouse covered. Inasmuch as the amount of the insurance exceeds $ 2,000, in determining whether the dependent coverage is a de minimis fringe benefit, the taxpayer must consider the excess (if any) of the cost of such insurance to each employee over the amount paid for the insurance by each employee on an after-tax basis. Using this approach, those employees who pay more than the cost of the uniform rates in Table I of section 1.79-3(d)(2) of the regulations will have no income.

Accordingly, we conclude that the DGLI provided to Taxpayer's employees is term insurance subject to section 1.61-2(d)(2)(ii)(B) of the regulations. The cost of the insurance will be based on section 1.79-3(d)(2). Employees who pay significantly less than the cost of the uniform rates in Table I of section 1.79-3(d)(2) such that the amount of the discount cannot be considered a de minimis fringe benefit will have income. That income will also be considered wages subject to the Federal Insurance Contributions Act (FICA) and Federal income tax withholding (ITW). The income is not wages for purposes of the Federal Unemployment Tax Act (FUTA).

CAVEAT:

Advice has not been requested and no advice is being provided regarding the inclusion in gross income of amounts received as policyholder dividends, loans, or cash withdrawals, upon surrender of the policy, or otherwise under the terms of insurance contracts associated with the Group Universal program.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.