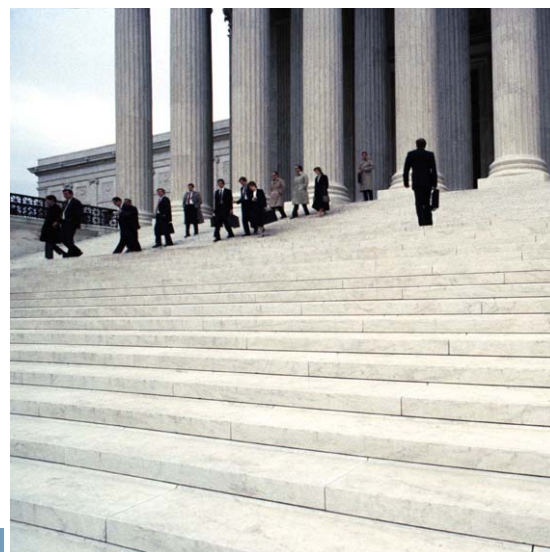


Legislative Brief

State Tax Issues For Dependent Coverage



Executive Summary

The Patient Protection and Affordable Care Act (PPACA) requires health plans and issuers that offer dependent coverage to make the coverage available until the adult child reaches the age of 26. When the health care reform law was passed, the federal tax code was also revised to take this new requirement into account. Therefore, for federal tax purposes, the value of employer-provided coverage for these adult children is excluded from the employee's gross income.

Tax issues arise for employees, and for the employers that administer payroll, when the state income tax laws do not match up to the federal laws.

This SullivanCurtisMonroe Insurance Services, LLC Legislative Brief describes how to address the tax issues that may impact employer-provided coverage in connection with the health care reform dependent coverage rules.

Federal Tax Treatment

Before PPACA was enacted, Internal Revenue Code (Code) Section 105(b) provided that an employee's child had to qualify as a tax dependent in order for the value of the child's employer-provided health coverage to be excluded from income, and therefore tax-free, at the federal level. Generally, a child had to be under age 19, or under age 24 if a full-time student, and had to rely on the employee for more than half of his or her financial support to be considered a tax dependent.

Under the tax changes related to PPACA, Code Section 105(b) was revised to accommodate the extended coverage requirement. The revised section states that coverage provided by an employer to an employee's child will be excluded from income through the end of the taxable year in which the child turns 26. This tax provision allows adult children to receive tax-free coverage beyond age 26, even though the health care reform requirement ends once the child has turned 26.

State Tax Issues

Although the extended dependent coverage can be excluded from income for federal tax purposes, not all state laws contain the same exclusion provisions. In addition, some states also require dependent coverage beyond age 26. In states where the tax law is inconsistent with federal law or additional coverage is required, employees may have to recognize additional income and pay tax on the value of the coverage.

Inconsistent State Laws

State tax laws are generally related to the federal tax code in some way. Some states have laws that are designed to automatically conform to changes in the Internal Revenue Code. This ensures that state and federal tax laws are always consistent. However, other states have tax laws that correspond to the Internal Revenue Code as it existed on a certain date or have different tax provisions altogether. These states would need to amend their laws to bring them into line with the federal rules.

As of Feb. 1, 2011, the states listed in the following chart have tax laws that do not conform to the Internal Revenue Code's provisions related to PPACA. It is expected that this list will change, as these states may consider such changes to their laws in the future. However, some states, such as California, have already considered and failed to pass conforming legislation during 2010. Additional efforts will be required to change the law.

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| STATES WITH NON-CONFORMING TAX LAWS | |
|-------------------------------------|----------------|
| Arizona | Maine |
| Arkansas | Massachusetts |
| California | Minnesota |
| Georgia | Oregon |
| Hawaii | South Carolina |
| Idaho | Virginia |
| Indiana | West Virginia |
| Kentucky | Wisconsin |

Extended State Dependent Coverage

A number of states have passed laws that require insured group health plans to cover dependents beyond age 26. For example, in New Jersey, unmarried children can stay on a parent's plan until they are 31 years old. Such state mandates, to the extent they require coverage past age 26, will continue to apply. In the event state laws mandate coverage past age 26, federal tax law requires employers to impute the fair market value of the coverage to employees for tax years after the child turns 26, or that employees pay for it on an after-tax basis.

According to the National Conference of State Legislatures, the states in the chart below have requirements for dependent coverage that exceed the federal minimum standard.

| STATE | DEPENDENT COVERAGE REQUIREMENT |
|--------------|---|
| Florida | Up to age 30 for unmarried children without dependents who are state residents or students and do not have their own coverage. (F.S.A. § 627.6562) |
| Illinois | Up to age 30 for unmarried dependents who are veterans and state residents. (215 ILCS 5/356z.12) |
| Nebraska | Up to age 30 for unmarried children who are state residents or full-time students and do not have their own coverage. (Neb. Rev. St. § 44-7,103) |
| New Jersey | Up to age 31 for unmarried children without dependents who are state residents or full-time students and do not have their own coverage. (N.J.S.A. 17B:27-30.5) |
| New York | Up to age 30 for unmarried children that are state residents. (NY Stat 3216(a)(4)(C)) |
| Ohio | Up to age 28 for unmarried children that are state residents or full-time students. (Ohio Rev. Code § 1751.14) |
| Pennsylvania | Up to age 30 for unmarried children without dependents who are state residents or full-time students. (40 P.S. § 752.1) |
| Wisconsin | Up to age 27 for unmarried children who do not have their own coverage. (W.S.A. 632.885) |

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Actions for Employers

If you are located in a state that either requires dependent coverage beyond the federal minimum age, or has tax laws that are not consistent with the federal tax code with respect to dependents, you may need to take some additional steps in administering the coverage. Note that these steps may vary due to subtleties in a state's laws.

- Request that employees provide information on covered adult children to determine whether they meet state dependent requirements.
- Provide information to applicable employees on state tax requirements and notify them that the value of the coverage for their adult children may need to be included on their W-2 forms as imputed income.
- Determine the fair market value of the employer-provided coverage. Methods used to determine this value include using the plan's COBRA premium or having an actuary calculate the fair market value.
- Impute income to employees for state tax purposes for the fair market value of coverage provided to adult children who do not qualify as state tax dependents.
- Report any imputed income on the employee's W-2 form (unless coverage was paid for on an after-tax basis).

Please contact your SullivanCurtisMonroe Insurance Services, LLC representative with any questions regarding your plan's dependent coverage.

This SullivanCurtisMonroe Insurance Services, LLC Legislative Update is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

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