



Compliance...the Bottom Line

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 employers when the state income tax laws do not match up to the federal laws.

This *Bottom Line* 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 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.

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 federal rules.

As of April 12, 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 frequently, as these states may consider changes to their laws. Due to the rapidly changing nature of this topic, employers should make sure to confirm state law requirements with the applicable state agency before taking any action related to taxation of the value of health benefits.

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STATES WITH NON-CONFORMING TAX LAWS	
Arkansas	Maine
Georgia	Massachusetts
Hawaii	Virginia
Idaho	West Virginia
Indiana	Wisconsin

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.

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 Laurus Strategies representative with any questions regarding your plan's dependent coverage.

Extended State Dependent Coverage

A number of states have passed laws that require insured group health plans to cover dependents beyond age 26. 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 who are state residents. (NY Stat 3216(a)(4)(C))
Ohio	Up to age 28 for unmarried children who 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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