

Health Care Reform Provides Federal Tax Relief for Adult Child Coverage

Apr 21 2010

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Practice Area: Compensation and Benefits/ERISA

The new health care reform legislation signed by President Obama last month provided some tax simplification for Wisconsin employers that provide health care coverage to the children of their employees. Unfortunately, these changes will not be effective for determining Wisconsin income tax or Wisconsin income tax withholding until the Wisconsin legislature acts to adopt these federal changes.

In our February 2010 Compensation & Benefits Legal Update (which can be found [here](#)), we highlighted income and employment tax issues raised by a change in Wisconsin law that extends the availability of dependent coverage under certain employer-provided group health plans to adult children of covered employees. Under Wisconsin Statute § 632.885, health insurance policies issued in the State of Wisconsin and self-insured government health plans operating in Wisconsin generally must provide that dependent coverage is available to the unmarried child of the insured if:

- the child is over age 17 but under age 27; and
- the child is not eligible for coverage under a group health benefit plan offered by his/her employer for which the child's premium contribution is no greater than the premium amount for his/her coverage as a dependent of the insured.

The coverage period under the Wisconsin statute may be extended if the child is called to active duty in the National Guard or a reserve component of the armed forces. This new Wisconsin law first applies to policies issued or renewed on or after January 1, 2010 (or, for collectively bargained agreements containing provisions for health plans or policies, the date the policies or plans are established, extended, modified, or renewed on or after January 1, 2010).

In our February update, we noted that the new Wisconsin mandate could impose significant tax issues for employers. At that time, we noted that the provisions of the Internal Revenue Code (the "Code") that exclude the value of health coverage provided by an employer from the employee's income for income tax, employment tax, and withholding purposes only extended to coverage provided to the employee, the employee's spouse, and the employee's dependents. In addition, we explained that the Wisconsin mandate could require an employer to provide coverage to the child of an employee who did not qualify as the employee's tax dependent. In that case, the employer would be required to include the fair market value of the coverage provided to that child in the employee's taxable income for income tax, employment tax, and withholding purposes.

On March 30, 2010, President Obama signed the Health Care and Education Reconciliation Act of 2010 (the "Act"), which was the second piece of the health reform legislation. Among a multitude of other changes, the Act modified Code section 105(b) to extend the tax exclusion for employer-provided health coverage to coverage provided to the child of an employee through the end of the tax year in which the child attains age 26 regardless of whether the child qualifies as the employee's dependent. For this purpose, the term "child" includes a son, daughter, stepson, stepdaughter or eligible foster child, i.e., a foster child placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction. This change was effective on the date of enactment (March 30, 2010).

For periods after March 30, 2010, the new law should simplify employer payroll administration with respect to **federal** income tax, employment tax, and withholding purposes. Employer group health plan coverage provided to the child of an employee will be excluded from the employee's taxable income through the end of the year in which the child attains age 26. If coverage for the child extends beyond the end of the tax year in which the child attains age 26, as in Wisconsin where the mandate extends coverage to age 27, then the fair market value of coverage provided to the employee's child will be excluded from the employee's taxable income only if the child qualifies as the employee's tax dependent. [For a summary of who qualifies as a "tax dependent" for purposes of employer-provided health coverage, please see our February article.]

Unfortunately, the extension of the tax exclusion under federal tax law for health plan coverage provided by an employer to an employee's adult child does not yet apply for Wisconsin income tax or Wisconsin tax withholding purposes. Before this change can be effective in Wisconsin, the Wisconsin legislature must act to adopt this change in federal law for Wisconsin state tax purposes. We have been informed that the legislature is not likely to consider this change until its budget session next January. Therefore, at least for the balance of 2010, it is likely that an employer will still be required to include the fair market value of coverage provided to the child of an employee in the employee's taxable income for Wisconsin tax purposes unless the child qualifies as the employee's tax dependent.

Given the current disparity between state and federal tax law, Wisconsin employers should consider obtaining a written certification from each employee with an adult child covered under the employer's health plan regarding the child's status as a tax dependent. If the child is not a tax dependent, the employer should include the fair market value of the child's health plan coverage in the employee's taxable income for State of Wisconsin wage and tax withholding purposes. If the child will be age 26 or less as of the end of the tax year, then, for periods of coverage after March 30, 2010, the employer should not include the value of the child's coverage in the employee's wages for federal income tax, employment tax, or withholding purposes. Finally, if the employer provides health plan coverage to the employee's child for periods after the end of the tax year in which the child attains age 26 and the child is not the employee's tax dependent, then the fair market value of the child's coverage should be included in the employee's taxable income for all state and federal purposes.

Although this article focuses on the Wisconsin mandate extending health coverage to adult children, you should be aware that the same tax considerations apply if, by its terms, the employer's health plan makes coverage available to children who might not qualify as dependents of employees.

Hopefully, the Wisconsin legislature will work quickly to adopt the federal extension of the exclusion for employer health coverage provided to the children of employees.

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