

Health Care Reform Alert: Immediate Imputed Income Relief under the New Health Care Reform Law

4/20/2010

Effective March 30, 2010, The Patient Protection and Affordable Care Act of 2010, together with the Health Care and Education Tax Credits Reconciliation Act of 2010 (collectively, the “Act”), amend Section 105(b) of the Internal Revenue Code to provide that medical reimbursements made to an employee are not taxable with respect to any child of the taxpayer through the end of the taxable year in which the child turns 26. The purpose of this alert is to inform employers, particularly Massachusetts employers, of the immediate effects of this provision on taxation of health coverage provided to children of employees.

Background

Generally, if an employer provides health coverage to an individual who is not a “dependent” of an employee, then the fair market value of the coverage provided to the nondependent is taxable to the employee under federal tax law as ordinary income. This additional income is typically called “imputed income.”

Under Federal Tax Code § 152, a “dependent” is either a “qualifying child” dependent or a “qualifying relative” dependent. A “qualifying child” is a child who lives with an employee for more than half a year, who is either under age 19 or is a full-time student under age 24, and who does not provide over half of his or her own support for the calendar year. A “qualifying relative” is an individual who bears a relationship to the taxpayer (including any child of the taxpayer who is not a “qualifying child,” regardless of the child’s age), whose gross income is less than the exemption amount (\$3,650 in 2010), and who receives over one-half of his or her support from the taxpayer. (But note that for purposes of the exclusion for employer-provided health coverage, the \$3,650 gross income limit does not apply to a qualifying relative.)

Since 2008, Massachusetts has required insured health plans to extend coverage to an employee’s children up to age 26 or two years following the loss of dependent status under the Internal Revenue Code, whichever occurs first. Connecticut and New York, among other states, have enacted similar laws requiring coverage of children who may not qualify as federal tax dependents. In some cases, this has required employers to cover children who are not “dependents” of an employee under federal tax law, and impute income to the employee.

Immediate Imputed Income Relief under the Act

Effective March 30, 2010, the Act amends Section 105(b) of the Internal Revenue Code to provide that medical reimbursements made to an employee are not taxable with respect to any

child of the taxpayer through the end of the taxable year in which the child turns 26, whether or not that child is a “dependent” under Section 152 of the tax code. “Child” is defined broadly to include a son, daughter, stepson, stepdaughter, legally adopted child, or foster child placed with the parent by judgment or decree.

The regulations under Internal Revenue Code Section 106 will need to be amended to ensure that *premiums* paid by the employer with respect to any child of the employee who as of the end of the taxable year has not attained age 27 are likewise not included in the employee’s income.

Practically, this means that Massachusetts employers no longer need to impute income with respect to children who have not attained age 27 by the end of a taxable year, even if those children do not meet the federal “dependent” definition.

Notes and Observations

Employers will need to continue to impute income with respect to certain other individuals who may be covered under a plan pursuant to state law or otherwise, but who are not “dependents” of the employee under Section 152 of the Code, such as same-sex spouses, domestic partners, or the children of either. The Act provides no relief for these individuals.

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For further information regarding this or any issue related to Health Care Reform, please contact one of the professionals listed below or the Mintz Levin attorney who ordinarily handles your legal affairs.

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