

Alert 10-123



Tax Treatment of Employer-Provided Health Coverage for Adult Children

On April 27, 2010, the Internal Revenue Service issued Notice 2010-38 that gives guidance on the income tax treatment of health care benefits provided to children in the year before they attain age 27. The notice addresses a hole left by the Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010 ("Health Care Reform"), which provides that effective as of March 30, 2010, reimbursements for health care provided to a child through the end of the year in which a child attains age 26 will be tax free. Health Care Reform, however, did not provide a similar exclusion from taxation for the value of coverage provided.

To close this gap, Notice 2010-38 provides that retroactive to March 30, 2010, the value of health insurance coverage for a child through the end of the year in which the child attains 26 is also excluded from an employee's gross income, and is not imputed as income to the employee. As a result, the cost of health insurance coverage remains excluded from wages for purposes of Federal Insurance Contributions Act ("FICA"), Federal Unemployment Tax Act ("FUTA"), the Railroad Retirement Tax Act ("RRTA") and federal income tax withholding.

Notice 2010-38 also provides that cafeteria plans, flexible spending arrangements ("FSAs"), and health reimbursement accounts ("HRAs") may pay benefits through December 31 of the year that a child attains age 26. Since employees may experience a change in status as a result of the new dependent coverage provisions, retroactive to March 30, 2010, Notice 2010-38 also permits affected employees to revoke their prior elections and make new elections for the same coverage period.

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We recommend that plans and procedures be reviewed for compliance with these changes. Although plan amendments may be effective retroactively to as early as March 30, 2010, amendments must be executed no later than December 31, 2010. If you have any questions, please contact one of the members of Reed Smith's Health & Welfare and Employee Benefits team listed below, or your Reed Smith attorney.

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