Dependents to Age 27 Tax Issues

- Expansion of Dependent coverage creates tax issues.
  - Tax-free health insurance coverage/benefits are based on the federal definition of "dependent" and guidelines.
  - Wisconsin's expansion of the definition of "dependent" to age 27 does not follow the federal definition.
- "Dependent" for income tax purposes based on federal guidelines under IRC Section 152.
  - Must be "qualifying child" or "qualifying relative".
  - Each has 4 tests to satisfy, but tests are different for each.
  - For medical coverage, expenses, etc., certain of the 4 tests are deemed satisfied (e.g., no Gross Income test for a qualifying relative).
- The value of health insurance coverage for an ineligible dependent (using the federal definition) is taxable to the EMPLOYEE to the extent not otherwise excludible under Section 106, based on the principles under Section 61.
  - Treated as wages subject to all payroll taxes
  - Portion of employee premium not excludible under Sec. 125
- The value of health claims paid on behalf of an ineligible dependent may be taxable to the extent the coverage is attributable to employer contributions or paid for by the employer, pursuant to Sections 104/105.
  - Claims paid for the taxpayer and *eligible* dependents are excludible from income.
  - To the extent the value ineligible dependent coverage is properly taxed or paid for by the employee, the coverage will be attributable employee contributions and nontaxable.
  - The interaction of the taxable value of coverage and the taxable value of claims paid to an ineligible dependent are not clear.
  - Failure to properly tax the value of such coverage may result in tax exposure for any insurance claims paid.
- Possible methods for valuing coverage for an ineligible Dependent:
  - Incremental cost for the additional dependent
  - COBRA cost to dependent (Preferred Method)
  - Actuarial value for the additional dependent
  - Per capita value based on number of covered dependents
  - External measures of value
- A proper valuation method under Section 106 may not satisfy the exclusion principles of Section 105.
- To the extent an employer does not take into account and apply the tax principles at hand with respect to health insurance coverage offered under Wisconsin's expanded dependent definition for an otherwise ineligible dependent, the EMPLOYEE might be exposed to adverse and potentially significant tax consequences.
- Watch for further guidance from the IRS.
- Identify ineligible dependents covered under the health plan.
- Make sure to properly tax the value of ineligible dependent coverage.
- Improper value could expose the EMPLOYEE to adverse tax consequences on claims paid.
- Effective Date – Plans that renew on or after January 1, 2010.
- You Should
  - Contact your insurer to determine what additional premium would be charged
  - Contact your accountant to determine any tax liability and if the additional premium being charged is properly valued.