



Changes to Imputed Income Tax Rules for Adult Child Health Insurance Coverage

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Recently, Governor Walker signed legislation which resolves an ongoing tax issue arising out of state and federal mandates to provide health insurance coverage to employees' adult children.

Background

As most will recall, in 2009, Wisconsin passed legislation which required that most group health plans (not private, self-funded plans) offer health insurance to an adult child of a covered employee through the child's 27th birthday.

Then, in 2010, the federal health care reform laws generally required group health plans to offer insurance coverage to a covered employee's adult child through the child's 26th birthday. Unfortunately, the state and federal laws excluded different health plans, the state law made adult children eligible for an additional year, and there were other eligibility inconsistencies.

Finally, in this year's budget bill, Wisconsin "federalized" its adult child coverage requirements: Effective for group health plans as they renew after January 1, 2012, the Wisconsin coverage mandate is now limited to an adult child of a covered employee through the child's 26th birthday and the child's marital status or ability to obtain coverage through his or her own employer does not affect eligibility. However, there was still some inconsistency in tax treatment.

Income Tax Treatment

Prior to 2009, employer-paid health insurance benefits for an adult child were considered taxable to the employee if the adult child was not otherwise considered a dependent for income tax purposes. As a result, an employee may have been required to pay both state and federal income tax on an adult child's health insurance coverage.

In 2010, the federal tax code was modified when the health care reform laws were enacted to ensure that the new health insurance benefits provided to an adult child would be exempt from federal income taxation until the year in which the adult child turned 27. However, as Wisconsin tax laws do not automatically follow changes in federal tax laws, coverage provided to an adult child was still taxable for Wisconsin income tax purposes, unless the adult child was otherwise considered a dependent for income tax purposes.

Fortunately, the newly enacted legislation, which is retroactive to January 1, 2011, corrects the situation by mirroring federal law: Employers will no longer be required to add the fair market value of health insurance benefits provided to an adult child to an employee's income until the year in which the adult child turns 27; and a parent-employee does not need to report the additional income on state income tax returns (again, until the year in which the adult child turns 27).

When preparing W-2's for 2011, employers should not include any income previously added for employees' adult children's health insurance coverage and employees will get a credit for taxes previously withheld.

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