



Health Coverage for Adult Children: A Practical Guide to Reporting Imputed Income Taxes

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We have recently been receiving questions from employers about how imputed income taxes resulting from health coverage provided to adult children should be reported for State and Federal income tax purposes. (Please see an article we published earlier, <http://www.wrpr.com/articles/WIandFedCoverageMandates.pdf>, for more background information on the provision of health insurance coverage for adult children under State and Federal laws). Based on those questions, we thought it would be helpful to provide you with additional information regarding State and Federal reporting requirements.

Reporting Imputed Income Taxes for Wisconsin Income Tax Purposes

Under current Wisconsin law, the general income tax dependency test employers are used to following still applies: an adult child must meet the definition of a dependent child for income tax purposes (or qualifying relative) to avoid imputed income tax consequences. Therefore, for 2010 income tax purposes, if an employee's adult child does not qualify as an income tax dependent or qualifying relative, the fair market value of the adult child's insurance coverage is considered income and taxable wages to the parent-employee.

According to the Department of Revenue, employers must include the amount that is taxable for Wisconsin income tax purposes in Box 16 of the 2010 Form W-2 or provide employees with a supplemental Wisconsin only form W-2, again with the taxable benefits reported in Box 16.

Also, the fair market value of the adult child's insurance coverage is subject to Wisconsin income tax withholding. However, employers who have retirees with coverage for adult children should provide those employees with the supplemental Wisconsin only form W-2.

Reporting Imputed Income Taxes for Federal Income Tax Purposes

Federal income tax laws were revised in connection with the enactment of the health care reform laws. Effective as of March 30, 2010, for Federal income tax purposes, imputed income tax or withholding rules do not apply to insurance coverage provided to an adult child who is 26 for the full tax year. Therefore, for Federal income tax purposes, there are two instances where coverage for adult children may trigger Federal imputed income tax consequences.

First, if coverage was provided to an adult child who did not meet the income tax definition of a dependent child (or qualifying relative) between January 1 and March 30 of this year, the fair market value of the adult child's coverage is considered income and taxable wages to the parent-employee for this period.

Also, to avoid Federal imputed income tax consequences after March 30, the adult child must be age 26 during the entire year. Therefore, Federal imputed income tax consequences will be triggered for the year in which the adult child turns 27. For example, if an adult child turned 27 on September 1, 2010 and coverage has been provided from January 1 (under the Wisconsin mandate, requiring coverage until the end of the month in which the child turns 27), employers will have to report the fair market value of the coverage provided in 2010. In this example, the general Federal withholding requirements would also apply for 2010 Federal income tax purposes.

What about FSAs, HRAs, and Similar Accounts?

For Federal income tax purposes, the IRS has clarified that cafeteria plans, FSAs, and HRAs can make distributions for adult children under age 27 without triggering income taxes. Adult children can be treated the same as other dependents under these types of accounts. (Therefore, note that cafeteria plans may need to be amended to include employees' adult children).

For State income tax purposes, if the adult child does not qualify as an income tax dependent, reimbursements for adult children from these types of accounts are taxable as income to the parent-employee. Here, again, employers must include the taxable amount (the value of the reimbursement) in Box 16 of the 2010 Form W-2 or provide the parent-employee with a supplemental "Wisconsin only" Form W-2 showing the taxable reimbursement in Box 16.

If you have any questions or would like to discuss any of the issues highlighted in this article, please do not hesitate to contact us.

This article should not be construed as legal advice and is intended for general informational purposes only. If you have any questions regarding this article, you should consult your legal counsel.