Tax Issues Related to
PEBB Non-Tax Qualified Dependent Insurance

January 1, 2011

Internal Revenue Code (IRC) Section 152 Tax Qualified Dependents

Employer contributions toward payment for health care are taxable to the employee if they are made for an individual who is not the employee's spouse or dependent child (i.e., a non-tax qualified dependent). Employees adding a non-tax qualified dependent (e.g., domestic partner, child of a domestic partner) to their employer sponsored insurance must identify their family tax status for the upcoming calendar year.

The employee will need to verify whether their dependents are dependents for tax purposes under IRC Section 152. If the dependent qualifies under IRC Section 152, the employer contribution toward the payment for the dependent's premium should not be treated as additional taxable income to the employee. If the dependent does not qualify under IRC Section 152, the fair market value of the employer contribution toward the coverage should be treated as additional taxable income to the employee (see below and Tables 1 and 2).

Required Retroactive Tax Treatment

The Health Care Authority (HCA) recommends that employees enrolling a non-tax qualified dependent review their tax status declaration annually during the PEBB open enrollment period. The declaration requires the employee to anticipate the dependency status of their dependent for the upcoming year.

It is also important for employees to report to their employer any changes in dependency status during the year because IRC Section 152 requires a "look-back" at the dependency status at the end of each calendar year. If dependency changes during the calendar year, a retroactive adjustment will be necessary.

Identified below are examples of status changes and instructions to correct them.

Examples of mid-year dependency status changes and instruction:

Situation:	**Result:**	**Employee notifies you of the change in dependent tax status:**	**Agency must:**	**Agency Action:**
1. Dependent qualifies as an IRC Section 152 dependent for a portion of the tax year *(For example: January to July)*[1]	The Fair Market Value (FMV) of coverage for non-tax qualified dependent is taxable income for the employee for the entire year	During the tax year	Collect the appropriate number of months of: • Federal Income Tax • Social Security Tax • Medicare Tax from the employee	• On the next 941 filed reflect the correction and file a 941c with an explanation • Verify W-2 provided in January reflects the FMV for the year
		After the end of the tax year	Collect appropriate months of : • Social Security Tax • Medicare Tax from the employee	• Verify W-2 provided in January reflects the FMV for the year • If W-2 has already been filed, file a W-2c showing corrected amount
2. Employee does not indicate dependent would qualify as an IRC Section 152 tax dependent for the entire tax year *(January-December)*	The Fair Market Value (FMV) of the coverage for the dependent is not taxable income for the employee for the entire year	During the tax year	Refund or credit the employee the appropriate months of: • Social Security Tax • Medicare Tax Optional, but not required, refund • Federal Income Tax to the employee	• On the next 941 reflect the correction and file a 941c with an explanation • Verify W-2 provided in January does not reflect the FMV for the year
		After the end of the tax year	Refund or credit the employee the appropriate months of: • Social Security Tax • Medicare Tax to the employee	• Verify W-2 provided in January does not reflect the FMV for the year • If W-2 has already been filed, file a W-2c showing corrected amount

[1]*A dependent must qualify as an IRC Section 152 dependent for the entire year in order to receive favorable tax treatment.*

Note: A dependent's death does not change his or her status for the portion of the year during which the dependent was alive. No adjustments would be required in the case of a death of a dependent.

IRS Section 152 Non-Qualified Dependents

Employees adding a dependent who does not meet the IRC Section 152 definition of qualified dependents will have additional taxable income, which needs to be taxed and reported.

There will be two taxation issues to be addressed.

Issue:	Action:	Resource:
1. State-share premium paid to the insurance carrier for non-qualified dependents	The Fair Market Value (FMV) of the coverage, less any after-tax contributions, is taxable to the employee and subject to: • Federal Income Tax • Social Security Tax • Medicare Tax *(Not subject to retirement)*	Appendix A, Tables 1 – 2 reports the fair market value (FMV)
2. Employee contribution for non-qualified dependents	• Do not deduct employee contributions for the IRC Section 152 non-qualified dependent on a pre-tax basis. *Payroll systems provide the ability to deduct pre and post-tax based on IRC Section 152 non-qualified dependents*	Appendix A, Tables 3 - 7

"Declaration of Tax Status" Form

Employees are required to complete a Declaration of Tax Status form to indicate whether his/her non-tax qualified dependent is an IRC Section 152 qualified dependent or not.

The IRS provides information on how to determine a dependent's tax status. The employee may use the *Worksheet for Determining Support* in IRS Publication 501 to assess whether a dependent enrolled on the employee's PEBB coverage qualifies as a dependent for tax purposes under IRC Section 152. The publication is available at www.irs.gov.

Employees with dependents that do not meet the Section 152 definitions will be able to continue to make premium contributions for their own insurance coverage with pre-tax payroll deductions even though contributions for the dependents must be deducted on a post-tax basis.

Questions

Direct any questions you have to your legal or tax advisor. Employees with questions should be directed to the IRS web site: www.irs.gov or to their tax advisor.

Note: National Health Care Reform has developed new requirements for reporting the aggregate cost of group health plan benefits (excluding FSA and certain other benefits) on each employee's W-2 for calendar year 2011. (i.e. W-2 forms issued in 2012 for 2011 wages and thereafter for subsequent years)

Appendix A – *HCA Finance and Administration Final 2011 PEBB Rates*

Additional Taxable Income for Non-Tax Qualified Dependents

Table 1: Employer Share Medical and Dental (FMV)

2011 Monthly State Premium Contribution for Medical and Dental for Active Employees Additional Taxable Income for Non-Tax Qualified Dependent Coverage

Medical and Dental Plan	Partner*	Subscriber's or Partner's Child(ren)*	Partner and Child(ren)*
All Medical Plans	$ 481	$ 380	$ 861

Table 2: Employer Share Dental Only (FMV)
Sample chart for dental only enrollment-taxable amount for dependents

Dental Plan	Partner*	Subscriber's or Partner's Child(ren)*	Partner and Child(ren)*
All Dental Plans	$ 48	$ 48	$ 96

*Premiums displayed are rounded to the nearest dollar, consistent with IRS tax reporting. The maximum state contribution (or index rate) is changed annually with the new insurance contracts, currently effective January 1 of each year, for the entire calendar year. The state contribution for employee is not displayed.

State and Higher Education Active Employee Monthly Contributions (Deductions) for Non-Tax Qualified Dependents

Table 3: Total Monthly Employee Contribution Owed for All Coverage (Pre-tax and post-tax combined)

Plan Name	Subscriber	Subscriber and Spouse	Subscriber and Child(ren)	Full Family
GHC Classic	$ 71	$ 152	$ 124	$ 205
GHC Value	$ 30	$ 70	$ 53	$ 93
Kaiser Classic	$ 105	$ 220	$ 184	$ 299
Uniform Medical Plan PPO	$ 60	$ 130	$ 105	$ 175

Table 4: Post-Tax Partner Share for “Subscriber and Spouse” Tier

Plan Name	Subscriber and Spouse	Subscriber	Partner
GHC Classic	$ 152	$ 71	$ 81
GHC Value	$ 70	$ 30	$ 40
Kaiser Classic	$ 220	$ 105	$ 115
Uniform Medical Plan PPO	$ 130	$ 60	$ 70

Table 5: Post Tax Partner Share for "Full Family" Tier

Plan Name	Full Family	Subscriber and Child(ren)	Partner
GHC Classic	$ 205	$ 124	$ 81
GHC Value	$ 93	$ 53	$ 40
Kaiser Classic	$ 299	$ 184	$ 115
Uniform Medical Plan PPO	$ 175	$ 105	$ 70

Table 6: Post Tax Partner and Child(ren) Share for "Full Family" Tier

Plan Name	Full Family	Subscriber	Partner and Child(ren)
GHC Classic	$ 205	$ 71	$ 134
GHC Value	$ 93	$ 30	$ 63
Kaiser Classic	$ 299	$ 105	$ 194
Uniform Medical Plan PPO	$ 175	$ 60	$ 115

Table 7: Post Tax Partner's Child(ren) Share for "Subscriber and Child(ren)" Tier

Plan Name	Subscriber and Child(ren)	Subscriber	Partner's Children
GHC Classic	$ 124	$ 71	$ 53
GHC Value	$ 53	$ 30	$ 23
Kaiser Classic	$ 184	$ 105	$ 79
Uniform Medical Plan PPO	$ 105	$ 60	$ 45

Appendix B – Scenarios as possible combinations of pre-tax and post-tax combinations

Subscriber <u>has</u> IRC Section 152:	Health Insurance Deduction should be:
Qualified Domestic Partner	Pre-Tax for employee's entire health insurance deduction[1] *(employee + partner)*
Qualified Domestic Partner and Qualified Dependent Children	Pre-Tax for employee's entire health insurance deduction[1] *(employee + partner + children)*
Qualified Dependent Child(ren)	Pre-Tax for employee's entire health insurance deduction[1] *(employee + child(ren))*
Subscriber <u>does not</u> have IRC Section 152:	**Health Insurance Deduction should be:**
Domestic Partner	Employee's portion – Pre-Tax Domestic Partner's portion – Post-Tax *Note: Tax employee for dollar value of state's share coverage for non-qualifying domestic partner also*
Domestic Partner and Dependent Child(ren)	Employee's portion – Pre-Tax Partner's portion – Post-Tax Child(ren)'s portion – Post-Tax *Note: Tax employee for dollar value of state's share coverage for non-qualifying domestic partner also*
Dependent Child(ren)	Employee's portion – Pre-Tax Child(ren)'s portion – Post-Tax *Note: Tax employee for dollar value of state's share coverage for non-qualifying child(ren) also*
Subscriber has a combination of IRC Section 152 Qualified and Non-Qualified Dependents:	**Health Insurance Deduction should be:**
Non-Qualified Domestic Partner and Qualified Dependent Child(ren)	Employee's portion – Pre-Tax Partner's portion – Post-Tax[1] Child(ren)'s portion – Pre-Tax[1] *Note: Tax employee for dollar value of state's share coverage for non-qualifying domestic partner also*
Non-Qualified Domestic Partner and Combination of Qualified and Non-Qualified Dependent Children	Employee's portion – Pre-Tax Partner's portion – Post-Tax Child(ren)'s portion – Post-Tax[2] *Note: Tax employee for dollar value of state's share coverage for non-qualifying domestic partner also*

[1] Any tax status change from/to non-qualifying during a calendar year will require adjustment to a non-qualifying taxable situation for the entire calendar year, including making retroactive tax changes. **Tax status should be re-verified annually to ensure employers accurately report taxable income and take appropriate employment taxes.**

[2] Since Health Care Authority does not split the premium on a child by child basis, there is no way to determine separately the portion of the employee's total deduction to pre-tax any qualified 152 children.