



DATE: December 7, 2010
TO: Our Valued Client Partners & Friends
FROM: HIB Account Team
RE: **LEGISLATIVE UPDATE 2010-24:**
Health Care Reform: California Taxation and Related Issues

We are pleased to bring you our **Legislative Update 2010-24: Health Care Reform: California Taxation and Related Issues**. This update provides details regarding health coverage provided to adult children and tax treatment. As always, please feel free to contact your HIB Account Team for assistance.

HEALTH CARE REFORM: CALIFORNIA TAXATION AND RELATED ISSUES

In the last few days, we have received a number of questions surrounding the failure of the California Legislature to adopt the federal income tax rules governing the tax treatment of health care coverage provided to adult children (age 24-26). Additionally, there has been some confusion over the availability of dental and vision benefits to adult children under California law ([SB 1088](#)). The purpose of this Memorandum is to address these two specific issues.

TAXATION

Under the Health Care Reform Law and pursuant to an IRS Notice ([2010-38](#)), group health coverage provided to adult children (up to age 27) will no longer result in imputed income to the employee effective March 30, 2010. Please refer to our Legislative Update 2010-11 for details. So, for federal income tax purposes, employers will no longer add the value of the coverage to an employee's wages. Unfortunately, the California Legislature failed to pass AB 1178 which would have provided the same break under California tax law. As a result, employers must impute income for the value of coverage provided to adult dependents for state tax purposes and may not allow pre-tax contributions for state tax purposes.

IMPUTED INCOME TAX

Historically, the customary method of calculating the value of group health care coverage for income tax purposes is somewhat vague. The shorthand rule would be to look at the COBRA (minus 2%) charged to provide that individual COBRA coverage. Despite what the employer may remit to the insurance carrier for full family coverage on a qualified beneficiary, the COBRA rate will usually be the cost of single coverage. This will vary based on the plan's overall rate structure (employee only, employee plus spouse, employee plus family), the premium rate with a family of four is the same for a family of five or even eight. So, if the employee has elected full family coverage and then enrolls an adult dependent pursuant to Health Care Reform, the employee still pays the same full family contribution as before. However, since the value of the coverage is the single rate (minus any after-tax employee contributions) the employee will receive additional compensation, for California income tax purposes, based on the single rate.



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STATE TAXATION RULES: AN OVERVIEW

Federal-State Tax Conformity Method	Description	States
Rolling conformity	State automatically adopts provisions of the IRC as enacted (i.e., on a continual basis)	Alabama, Alaska, Colorado, Connecticut, Delaware, District of Columbia, Illinois, Kansas, Louisiana, Maryland, Massachusetts, Missouri, Montana, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Rhode Island, Tennessee, and Utah
Fixed date conformity	State follows the IRC as of a certain, fixed date. Deliberate legislative action is required to update the IRC conformity date	Arizona, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Maine, Michigan (but taxpayers can elect to use the current IRC), Minnesota, New Hampshire, North Carolina, Ohio, Oregon, South Carolina, Texas, Vermont, Virginia, West Virginia, and Wisconsin
Selective conformity	State adopts only certain IRC provisions as of a specific date or makes certain material changes to key IRC provisions	Arkansas, California , Mississippi, New Jersey, and Pennsylvania
Mixed/No conformity	Certain states do not impose corporate or personal income taxes at all so changes to the IRC have no impact on state income taxation	States that do not impose corporate taxes: Nevada, South Dakota (except for financial services companies), Washington and Wyoming States that do not impose personal income taxes: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. New Hampshire and Tennessee apply it only to income from interest and dividends

DENTAL AND VISION COVERAGE

Recently, Vision Service Plan provided a notice to its contract holders that adult children must be eligible for vision benefits. It's now clear that the California law adopting the federal Health Care Reform rule for making coverage available to adult dependents is to be identical in all respects (other than taxation) to the federal rule. This means medical only *unless the dental and/or vision plan is an integral part of the medical package*.

THE MEANING OF INTEGRAL

Dental and vision are integral parts of the medical plan unless:

- i The dental or vision plan is under a separate contract; and,
- i Employees can elect dental or vision separately; and,
- i Employees pay an additional contribution amount for the coverage.

If not, Plan Sponsors must offer dental and vision to adult dependent children as a part of their medical package offering.



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WHAT YOU SHOULD DO

1. It is even more important now for California employers to conduct a survey of all dependents covered under their respective group health plans.
2. If employees who enroll in the medical plan automatically get coverage under a dental or vision plan with no additional contribution requirement, then the adult children get dental and vision as well. If the dental and vision plans require separate elections, then adult children will have access to medical only.
3. Initiate discussions with your payroll service immediately.

We will continue to provide you with information on HCR matters as they develop.

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