



**DATE:** April 6, 2011  
**TO:** Our Valued Client Partners & Friends  
**FROM:** HIB Account Team  
**RE:** **LEGISLATIVE UPDATE 2011-3: California Legislation Provides Tax Relief**

---

We are pleased to bring you our **Legislative Update 2011-3: California Legislation Provides Tax Relief**. This memorandum provides an update regarding state imputed income for California employers who offer coverage dependent coverage. As always, please feel free to contact your HIB Account Team for assistance.

## CALIFORNIA LEGISLATION PROVIDES TAX RELIEF

In late March 2011, the California legislature passed and sent to Governor Brown legislation ([AB 36](#)) which will provide both administrative and tax relief to California employers and their employees. At this time the Governor has yet to sign it into law. Upon its enactment, California will adopt the federal rules regarding the tax treatment of adult dependents electing group health care coverage pursuant to the Patient Protection and Affordable Care Act (PPACA) and related laws (HCR).

### SIMPLE MEANING

1. **Effective Date.** California has adopted the change in tax rule as if it took effect retroactively to the date of the original tax rules issued by the IRS for adult children under age 27 (i.e. ages 24 through 26).
2. **Plans Affected.** Group health plans which have become subject to HCR provisions (i.e. plans whose plan years began on or after September 23, 2010) who have offered coverage to adult dependent children pursuant to the HCR rules.
3. **Relief Provided:**
  - Employers will not be required to add imputed income for state income tax purposes to an employee's W-2 resulting from the addition of adult dependent children (as defined by HCR rules) to the employer-sponsored group health plan.
  - Plan participants will not be taxed on the value of adult dependent coverage meeting the HCR rules.

### DISCUSSION

**Origins of AB 36.** In the 2010 session of the California legislature, the Senate Appropriations Committee blocked the passage of a broader Health Care Reform tax bill, AB 1178 (containing the age 24-26 conforming rule), which was consistent with California's not adopting federal rules on pre-tax contributions to Health Savings Accounts. The rationale for not adopting the federal rules was that the State could not afford to give up the tax revenue. AB 36 is a slimmed down version containing only the age 24-26 taxation issue, resulting in less revenue loss.

**What AB 36 Does NOT Do.** AB 36 leaves California's dependent definitions intact, requiring student status to age 24 for all purposes other than group health plans. This is consistent with federal law including HCR rules.

**Relief Commensurate with the Federal Rules.** Eligible dependents under the HCR rule are:

- Not required to live at home;
- Not required to be a dependent on the employee's tax return;



### LEGISLATIVE UPDATE 2011-3

#### California Legislation Provides Tax Relief

April 6, 2011

Page 2

- Not required to be a student; and,
- Merely need to be a child of the participant (including adopted children).

The Marriage Issue and Access to Other Coverage. Additionally, the new Rule applies to married and unmarried children. Between now and January 1, 2014, for purposes of grandfathered plans only, adult children will not be eligible for coverage if they have access to an employer-provided health plan. This exception does not apply to non-grandfathered plans. As of January 1, 2014, all plans must not deny coverage due to availability of group health coverage elsewhere. It is important note that the Interim Final Rule only requires coverage for the dependent, not the spouse of the dependent (and, by extension, the dependent's domestic partner).

Domestic Partners. Since domestic partnerships are not recognized under federal law, the Interim Final Rule does not mandate coverage for domestic partners. Plans which cover domestic partners whether voluntarily or in compliance with state laws may consider eligible dependents as eligible but are not required to do so under the Interim Final Rule.

Employee Contributions. The employer must charge the same premium contribution for adult children as it does for other similarly situated dependents.

Eligibility. The criteria that issuers may use for determining eligibility are limited to the relationship between child and the plan participant. Premiums cannot vary based on age or residency or pre-existing conditions.

Special Enrollment Rights. For purposes of the election, and as a special open enrollment right under the Health Insurance Portability and Portability Act (HIPAA), the dependent must be offered all the benefit packages that are available to similarly situated employees who have not lost coverage. If the parent is not enrolled, but otherwise eligible to enroll, the plan must allow the parent to enroll. Additionally, if already enrolled, the parent can switch package options at the time of the dependent's election.

COBRA. If the over-age dependent has elected COBRA, he/she may elect coverage under the active plan and drop COBRA coverage. At the time the dependent loses coverage at age 26 (or later) he/she will have full COBRA rights restored (i.e. 36 months, etc.).

#### **The Tax Rule ([IRS Notice 2010-38](#)):**

Removal of Imputed Income Tax. The law removes the imputed income tax requirements on over-aged dependents up to age 27 (i.e. through age 26), relieving employers from having to impute income for employer-provided health coverage to children over-age 19 who do not meet the definition of qualifying child, which requires that they be full time students and living with the taxpayer (IRC Section 152(f)(1)). This rule became effective as of March 30, 2010 for federal tax purposes.

The Meaning of "Age 27." For purposes of this new law, the coverage provided is tax free through December 31 (end of the taxpayer's tax year), for the year in which the participating dependent turns 27.

**Unwinding 2010 Imputed Income.** State taxes collected and income included in 2010 for adult dependents which appear on the employee's 2010 W-2 must be credited in their entirety. The employer may need to issue a corrected W-2, and should seek the advice of their tax advisor.



### LEGISLATIVE UPDATE 2011-3

California Legislation Provides Tax Relief

April 6, 2011

Page 3

**Taxes Collected in 2011.** State income taxes collected and income reported to date should be credited against the remaining state income tax obligation for 2011. Some employers took a “wait and see” attitude and did not include the imputed income or state income tax withholding for adult dependent coverage. At present, it would appear they have no obligation to act on the matter.

**AB 36 Modifies Unemployment Code.** AB 36 also modifies the unemployment tax rules by removing the age 24-26 imputed income amounts from its definition of wages.

To access archived Legislative Updates, please visit [www.heffins.com](http://www.heffins.com) and click on “Employee Benefits.”

**Unsubscribing** – You are receiving this email as a client partner or friend of Heffernan Insurance Brokers. If you would like to unsubscribe please reply to this email by writing “unsubscribe” in the subject line.

*Copyright © 2011 Alfred B. Fowler, Attorney at Law. All Rights Reserved. Reprint with permission only.  
This legislative update is published as an information source for our clients and colleague. It is general in its nature and is no substitute for legal advice or opinion in any particular case. [mike@abferisa.com](mailto:mike@abferisa.com)*

*IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any tax advice contained in this communication, unless expressly stated otherwise, was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matter(s) addressed herein.*