

THE TAX EQUITY FOR HEALTH PLAN BENEFICIARIES ACT (H.R. 1820) PROVIDES UNIFORM TAX TREATMENT FOR EMPLOYER-PROVIDED HEALTH INSURANCE

Background. In growing numbers, employers across the country have made the business decision to provide health benefits to domestic partners of their employees. As of January 2007, 53% of Fortune 500 companies (265) were providing such coverage. This is more than a twelve-fold increase from 1995 and underscores a clear trend in the American workplace. Federal tax law has not kept up with the corporate changes in this area, however, and employers that offer such benefits and the employees who receive them are taxed inequitably.

The Issue. Currently, the Internal Revenue Code (Code) excludes from income the value of employer-provided insurance premiums and benefits received by employees for coverage of an employee's spouse and dependents, but does not extend this treatment to coverage of domestic partners or other persons who do not qualify as a "dependent" (such as certain grown children living at home who are covered under a parent's plan or children who receive coverage through a grandparent or parent's domestic partner). In addition, when calculating payroll tax liability, the value of non-spouse, non-dependent coverage is included in the employee's wages, thereby increasing both the employee's and employer's payroll tax obligations. An employee of median income level who receives employer-provided major medical coverage of average cost for himself and a domestic partner faces an annual tax bill of \$4,710 in income and payroll taxes, \$1,555 (or nearly 50%) more than that paid by a similarly situated co-worker with spousal coverage. The current inequitable tax regime also places significant administrative burdens on employers. It requires employers to calculate the portion of their health care contribution attributable to a non-spouse, non-dependent beneficiary and to create and maintain a separate system for the income tax withholding and payroll tax obligations for employees using such coverage.

THE SOLUTION. Equalize Tax Treatment For Employer-Provided Health Coverage For Domestic Partners and Other Non-Spouse, Non-Dependent Beneficiaries. Representative Jim McDermott (D-WA) has introduced legislation (The Tax Equity for Health Plan Beneficiaries Act, H.R. 1820) that would end the federal tax inequities for employer-sponsored health coverage provided to domestic partners and other non-spouse, non-dependent beneficiaries, as detailed below.

- ***Exclusion of Employer-Provided Health Insurance.*** The value of employer-provided health insurance for a domestic partner or other non-dependent, non-spouse beneficiary would be excludible from the income of the employee if such person is an eligible beneficiary under the plan. Employers would retain the current flexibility to establish their own criteria for demonstrating domestic partner status. In a corresponding change, the cost of health coverage for domestic partners or other non-spouse, non-dependent beneficiaries of self-employed individuals (e.g., small business owners) would be deductible to the self-employed person.
- ***Pre-Tax Cafeteria Plan Elections.*** The legislation would make clear that employees paying for health coverage on a pre-tax basis through a cafeteria plan would be able to do so with respect to coverage for a domestic partner or other non-spouse, non-dependent beneficiary.
- ***Voluntary Employees' Beneficiary Associations (VEBAs).*** Many employers, particularly in the collectively bargained context, use tax-exempt VEBAs to provide health coverage. Today, VEBAs are prohibited from providing more than de minimis benefits to a domestic partner or other non-spouse, non-dependent beneficiary. The legislation would permit a VEBA to provide full benefits to non-spouse, non-dependent beneficiaries without endangering its tax-exempt status.
- ***Health-Related Savings Accounts.*** In contrast to current law, employees would be permitted to reimburse medical expenses of a domestic partner or other non-spouse, non-dependent beneficiary from a health reimbursement arrangement ("HRA") or health flexible spending arrangement ("Health FSA").
- ***Payroll Tax Improvements.*** The value of employer-provided health coverage for a domestic partner or other non-dependent, non-spouse beneficiary would be excluded from the employee's wages for purposes of determining the employee's and employer's FICA and FUTA payroll tax obligations.