

## DOMESTIC PARTNER TAX EXAMPLE

When an employer provides health insurance for the spouse or dependents of an employee, federal tax law allows the value of the health insurance coverage to be excluded from an employee's gross income. No such exclusion exists under current law for health insurance provided by an employer to an employee's domestic partner or the dependents of an employee's domestic partner.<sup>1</sup> Accordingly, the value of the health insurance coverage provided by an employer (including coverage paid for with employee pre-tax contributions) for an employee's domestic partner or the dependents of an employee's domestic partner is income that is imputed to the employee and subject to federal income and payroll taxes. As a result, individuals that secure employer-provided health insurance coverage for themselves and their non-spouse, non-dependent family members face a significant tax penalty; one that, depending on the facts applicable to the specific individual, can be in the thousands of dollars per year and result in an individual paying in excess of 50% more in federal taxes.

**EXAMPLE 1.** Employee A is 35 years of age, earns \$32,760 per year,<sup>2</sup> and has a federal tax liability for 2007 of \$3,210.<sup>3</sup> Employee A has self-only health insurance coverage under his employer's group health plan, and the \$373 monthly premium attributable to such coverage is paid for by his employer.<sup>4</sup> Because federal law excludes from an employee's income the value of health insurance coverage provided to the employee by an employer, Employee A is not taxed on the value of the coverage provided to him by his employer. Employee A's federal tax liability remains unchanged at \$3,210.

**EXAMPLE 2.** Employee B is also 35 years of age and earns \$32,760 per year, but has family health coverage under his employer's group health plan for himself and his spouse.<sup>5</sup> The employer pays the monthly premium of \$1,009 attributable to Employee B's family coverage.<sup>6</sup>

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<sup>1</sup> Note: Although not discussed herein, there are certain limited circumstances under which a domestic partner can qualify as a "dependent" under federal tax laws for the purposes of receiving tax-free employer-provided health insurance coverage.

<sup>2</sup> The income selected is based on median income on 2005 federal income tax returns as reported by the IRS, projected forward to 2007 assuming a 3 percent annual increase. *See* <http://www.irs.gov/taxstats/article/0,,id=102886,00.html>.

<sup>3</sup> The applicable federal payroll tax rate (*i.e.*, 7.65%) and federal marginal income tax rates and the calculation of federal tax liability are based on 2007 federal tax laws, assuming that the taxpayer claims the standard deduction and one exemption (with phase-out of the personal exemption included, as applicable). Given that the value of the health insurance coverage provided to Employee A is excludable from income, Employee A incurs no payroll tax liability with respect to the coverage provided.

<sup>4</sup> The average monthly premium for employer-sponsored self-only or individual coverage was \$373 for 2007. *See* The Kaiser Family Foundation, Employer Health Benefits, 2007 Survey (stating that the average annual premium for employer-sponsored self-only or individual coverage for 2007 was \$4,479). *See* <http://www.kff.org/insurance/7672/upload/Summary-of-Findings-EHBS-2007.pdf>.

<sup>5</sup> For the purposes of Example 2, it is assumed that the spouse does not work outside the home and has no additional income.

<sup>6</sup> The average monthly premium for employer-provided family coverage was \$1,009. *See* The Kaiser Family Foundation, Employer Health Benefits, 2007 Survey (stating that the average annual premium for employer-sponsored family coverage for 2007 was \$12,106).

Given that federal law excludes the value of health insurance coverage provided by an employer to an employee and his or her spouse or dependent, Employee B is not taxed on the value of health insurance coverage provided to him and his spouse by his employer. Employee B's federal tax liability remains unchanged at \$3,210.<sup>7</sup>

**EXAMPLE 3.** Employee C is also 35 years of age and earns \$32,760 per year. Employee C has family health coverage under his employer's group health plan for himself and his domestic partner, Partner C. Under the terms of the group health plan, the employer pays the monthly premium amount of \$1,009 for family coverage for Employee C and Partner C. Because federal tax law does not exclude from an employee's income health insurance coverage provided to an employee for his or his domestic partner, the value of the coverage provided to Partner C is imputed to Employee C and is subject to federal income and payroll taxes. As a result, \$7,632 of income is imputed to Employee C and Employee C's federal tax liability increases from \$3,210 to \$4,939 (comprised of \$584 of payroll tax and \$4,355 of income tax).<sup>8</sup> This represents a 54% increase in Employee C's federal tax liability for 2007.

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<sup>7</sup> For the purposes of Example 2, it is assumed that Employee B and his spouse file separate returns.

<sup>8</sup> Although federal tax law is somewhat unclear on how to value the health insurance coverage provided to an employee's domestic partner or the dependent of an employee's domestic partner, most employers value the coverage by subtracting the difference in employer paid premiums for self-only or individual coverage versus family coverage (or employee plus one coverage if available). Under this approach \$7,632 of income would be imputed to Employee C and would be subject to federal income and payroll taxes. This is derived by subtracting the monthly cost of self-only coverage (\$373) from the monthly cost of family coverage (\$1,009), and multiplying this dollar amount (\$636) by 12 months. Under an alternative approach used by some employers, where the valuation is based on the cost of self-only coverage, Employee C would have imputed income equal to \$4,476 (which is derived by multiplying the monthly cost of self-only coverage (\$373) by 12 months). Under this approach, the federal tax liability of Employee C would increase by 31.6% to \$4,224 (comprised of \$342 of payroll tax and \$3,882 of income tax).