

The Tax Parity for Health Plan Beneficiaries Act

Background. In growing numbers, employers across the country have made the business decision to voluntarily provide health benefits to domestic partners of their employees. As of March 2011, 58% of Fortune 500 companies (291) were providing such coverage. This is more than a thirteen-fold increase since 1995. Federal tax law has not kept up with corporate changes in this area, however, and the employees who receive these benefits are taxed inequitably.

The Issue. Currently, the Internal Revenue Code excludes from income the value of employer-provided benefits received by employees for coverage of a spouse and dependents, but does not extend this treatment to coverage of domestic partners or other persons who do not qualify as spouse or dependent (such as certain grown children living at home who are covered under a parent's plan or certain 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 \$8,629 in income and payroll taxes, \$2,270 (36%) more than that paid by a similarly situated co-worker with spousal coverage. The current inequitable tax regime also places 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 maintain a separate system for income tax withholding and payroll tax obligations.

The Solution. The Tax Parity for Health Plan Beneficiaries Act 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 an employee's domestic partner or other non-dependent, non-spouse beneficiary would be excludible from the employee's income if such individual is an eligible beneficiary under the plan.
- **Self-Employed Deduction for Health Premiums.** 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.
- **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"), health flexible spending arrangement ("Health FSA"), or health savings account ("HSA"). In addition, employers that use a special account associated with a defined benefit pension plan to finance retiree medical expenses (a "401(h) account") would be allowed to use such account to pay the expenses of a retired employee's domestic partner or other non-spouse, non-dependent beneficiary.
- **Voluntary Employees' Beneficiary Associations (VEBAs).** A number of employers 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.
- **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.