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Adult Child Health Coverage – Wisconsin May Yet Conform Its Tax Law This Year

Wisconsin is the only state that has not yet conformed its income tax law to the federal tax treatment of employer-paid adult child health coverage. Generally, both federal and Wisconsin law require employer-sponsored health plans that offer "dependent" coverage to make such coverage available to an employee's children to age 26, whether the plan is insured or self-funded.

Federal tax law was amended on March 30, 2010 to exclude from an employee's taxable income the value of employer-paid health coverage for the employee's child (natural, adopted, foster or stepchild) to the end of the calendar year in which the child attains age 26. Nevertheless, in Wisconsin, the value of this coverage is excluded from the employee's taxable income only if the adult child is a "dependent" of the employee as defined under the pre-March 2010 Internal Revenue Code rules. As a result, employers are obligated to impute income and withhold taxes based on the fair market value of employer-paid adult child health coverage if the child does not meet the previous Internal Revenue Code dependent definitions. This applies whether the employer's plan is insured or self-funded; ERISA preemption does not apply here.

Many legislators and the Wisconsin Department of Revenue would like to see Wisconsin's law harmonized with federal law and the tax laws of the other states. The primary stumbling block has been a fiscal estimate showing a $23 million annual revenue loss to state coffers if such legislation is enacted. Many business and employee benefit professionals believed that this estimate significantly overstated the cost to enact this change.

As a result, a business group working through Wisconsin Manufacturers and Commerce (WMC) and Wisconsin's Office of the Commissioner of Insurance (OCI) gathered industry information to develop a more accurate estimate of the cost of harmonizing Wisconsin's tax law with federal law and the laws of other states. Reinhart Attorney Gail M. Olsen took a critical role in providing information to OCI. Reinhart Attorney Don M. Millis was involved in organizing the WMC group. As a result of these efforts, earlier this week the Department of Revenue revised its fiscal estimate down to a $1.8 million annual revenue loss.

A fiscal impact of $1.8 million per year makes it much more likely that the Legislature will enact legislation excluding the value of employer-paid adult child

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health coverage from an employee's taxable income. Action is expected before the end of the fall legislative period on November 3, 2011. Although the sponsors of the legislation have indicated that it will be effective retroactively to January 1, 2011, the fiscal estimate document indicates an effective date of January 1, 2012. This puts employers in a difficult position with respect to compliance. Please contact your Reinhart attorney, or any of the following Reinhart attorneys if you have any questions about this or any other tax or employee benefit issues.

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