

Benefits Compliance

2011-1

Imputed Income Issues for Employers

This Bulletin provides summary information about four “imputed income” areas you might want to review with your Payroll provider, Tax or Accounting Department, or outside CPA to see if you need to change your tax withholding procedures for 2011.

Summary of the Issue

Generally, employees are not taxed on the value of employer-provided benefits for the employee and his or her dependents. There are important exceptions to this rule, however. One exception is for benefits provided to certain categories of individuals who do not meet either federal or state law definitions of “dependent” – such as those listed below. Two other exceptions noted below apply for group term life insurance and long-term disability (LTD) insurance benefits. The amount that is taxable to an employee is considered “imputed income” to the employee.

1. Group Health Plan Coverage for Adult Children of Employees

The issue: You may have to impute income for state tax purposes (e.g., California), even though not for federal tax purposes.

The new Health Care Reform law requires that group health plans (both insured and self-funded) that cover employees’ dependents must offer coverage to age 26. Subsequent guidance provides that employer-paid coverage for adult children is not subject to Federal income tax. Not all states conform to Federal tax rules, however. In some states (e.g., California), the fair market value of coverage for adult children remains subject to state income tax to the extent the coverage is paid by the employer or by the employee

on a pre-tax basis, unless the employee certifies that the adult child meets the Federal Tax Code definition of “dependent.” Employers should seek state-specific advice from their Payroll provider.

(Note that in California, [AB 36](#) has been introduced, to conform the California Revenue and Tax Code to the federal Tax Code with regard to coverage for adult children dependents. If it is enacted, AB 36 would eliminate this imputed income issue for California employees. It appears this would be retroactive to March 30, 2010, since the bill says it “shall apply in the same manner and to the same periods as the federal amendments referred to.” A vote is expected in the Assembly in mid-February, and in the Senate probably by the end of March. No guarantees, but it seems likely the bill will be enacted.)

2. Group Health Plan Coverage for Domestic Partners and Their Children

The issue: You may have to impute income for federal tax purposes, even though not for California state tax purposes, for individuals who are “registered domestic partners” or same-sex spouses under California law but who are not “Tax Code dependents” under federal law.

Additionally, if an employee claims an individual as his or her “Domestic Partner” but the employee and individual are not “registered” Domestic Partners,

Benefits Compliance

2011-1

employer contributions toward group health coverage for this person will be subject to both California and federal tax withholding, unless the employee certifies that this non-registered domestic partner meets the Tax Code definition of “qualifying relative.”

(Non-registered “domestic partners” are often opposite-sex partners.)

3. Group Term Life Insurance for Employees

The issue: You must impute income for life insurance coverage above \$50,000; coverage of any amount for “key employees” provided through a discriminatory plan; employer-paid coverage in excess of \$2,000 for spouses or dependents; and employee-paid supplemental life insurance that is provided under a plan that “straddles” the IRS Table I rates. (See Table I rates at the end of this Bulletin.)

Coverage in excess of \$50,000. All participants will have imputed income on premiums for group term life insurance in excess of \$50,000, if such premiums are paid by the employer or are paid on a pre-tax basis by employees (i.e., paid through a cafeteria plan). The imputed income amount is based on the IRS Table I rates. There are a few exceptions, such as coverage provided after an employee becomes disabled; any portion of coverage for which the employer is directly or indirectly the beneficiary; and coverage for which a charity is the sole beneficiary.

Discriminatory plan. If your group term life insurance

plan discriminates in favor of any “key employee”—either as to eligibility or as to the kind or amount of benefits—then all “key employees” covered under the plan must include in taxable income the cost of the first \$50,000 of coverage. The amount taxable to the key employees is the higher of actual cost or Table I cost. There are no tax consequences to non-key employees in the plan.

Coverage in excess of \$2,000 for spouses or dependents. If the employer pays the premium for life insurance with a face amount of more than \$2,000 for an employee’s spouse or dependents, the entire premium amount is imputed income for the employee. If the life insurance is less than \$2,000, however, the coverage is excludable as a “de minimis” fringe benefit under IRC Section 132, and there is no imputed income for the employee.

The plan “straddles” the Table I rates. If you offer employee-paid supplemental group term life insurance, employees who pay less than the IRS Table I rates will have imputed income equal to the difference between the Table I rates and the amounts they pay. Employees who pay more than the Table I rates will not have imputed income. Sometimes an employer’s rates violate this rule by only a few cents (or less) per \$1000 in one or two age bands, and this is easily remedied by re-structuring the rates so there is no “straddling” (i.e., so all employees’ rates are either higher than, the same as, or lower than the Table I rates for their age brackets). The situation that should be remedied immediately is where the employer charges older (and usually higher-paid) employees less than the Table I rates, while charging younger (usually lower-paid) employees more than the Table I rates, resulting in the younger employees “subsidizing” the rates paid by older employees.

Benefits Compliance

2011-1

4. Long-Term Disability “Gross-up” Plans

The issue: Employers who pay the premiums for employees’ long-term disability (LTD) insurance may want to impute income equal to the premium amount, so that if an employee becomes disabled, benefits received will not be taxable.

If LTD premiums are paid with after-tax employee dollars, any benefits received will not be subject to taxation; however, if the premiums are paid by the employer or with employee pre-tax dollars, any benefits received will be taxable. Some employers offer arrangements under which employees can elect annually whether they or the employer will pay their LTD premiums for the upcoming year. Other employers pay the LTD premium and then impute income only for certain categories of employees (often management employees). You must discuss with your carrier how premiums will be paid before you implement such arrangements.

Next Steps

If you think any of the imputed income items discussed above might apply to your company, contact your Payroll Advisor, Tax or Accounting Department, or outside CPA for guidance on whether you need to change your payroll or tax withholding procedures for 2011.

Table 1. Cost per \$1,000 of Group Term Life Insurance

Age	Cost per \$1,000
Under 25	\$0.05
25 through 29	\$0.06
30 through 34	\$0.08
35 through 39	\$0.09
40 through 44	\$0.10
45 through 49	\$0.15
50 through 54	\$0.23
55 through 59	\$0.43
60 through 64	\$0.66
65 through 69	\$1.27
70 and older	\$2.06

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If you have questions, contact Lisa-Klinger@Leavitt.com

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