



the BENEFIT report



MULTIPLE BENEFIT SERVICES, INC

Annual Reminder of Possible Tax Consequences of Health and Welfare Plans

This is the time of the year we remind employers and plan sponsors that you may be faced with the responsibilities of managing tax implications and possible withholding requirements of certain employer-sponsored group benefits. The Internal Revenue Code determines the taxable nature of health and welfare plan benefits and their contributions. The following is a brief summary of a few year-end tax issues to consider:

Group Health Plans

State and/or federal legislation may affect the taxability of certain dependent coverage premiums if the covered dependent does not meet the definition of a dependent under the Internal Revenue Code, even if the plan is mandated to provide the coverage. If a covered individual does not qualify as the employee's dependent under the Code, the portion of premiums attributable to his or her coverage is not permitted to be paid on a pre-tax basis through any cafeteria plan.

Recently, New York and Illinois joined other states such as Florida, Utah and New Jersey to extend dependent coverage for employer-provided group health insurance. At last count, perhaps as high as 30 states have mandated insurance plans to extend dependent coverage. Until these recent changes, most plans did not cover dependents after age 19, or age 23 if they were not enrolled in college full-time and financially dependent on the employee.

Whether your fully insured health plan is mandated or your self-funded plan voluntarily provides coverage to older dependents, same-sex spouses or domestic partners, which do not conform to the Internal Revenue Code definition of dependent, any premium must be taxed appropriately. Cafeteria plan documents and any related notices need to reflect this taxation, and payroll or accounting departments should make sure they are properly processing and taxing any premium deduction.

On a different note, the IRS has released the 2009 version of Form 8889 and its Instructions where Health Spending Account (HSA) holders and their beneficiaries will need to report their contributions, distributions and any potential income or tax triggered by failure to remain HSA-eligible throughout the testing period.

Insurers and administrators should be prepared to generate any applicable MA 1099-HC forms by January 31st for Massachusetts's residents who need to report on their state income tax forms if they have health coverage. Additional information may be found at www.dor.state.ma.us.

Group Term Life Insurance Benefits

- Group term life insurance is a tax-free benefit to the employee if the coverage provided to the employee does not exceed \$50,000 and the plan is not discriminatory.
- Group term life insurance coverage in excess of \$50,000 that is provided by the employer at no cost to the employee is taxed as income to the employee at the Table I rate (described below).
- Group term life insurance coverage in excess of \$50,000 that is paid by the employee on a pre-tax basis under a cafeteria plan is taxed at the Table I rate (described below), and the pre-tax salary reductions are excluded from the employee's income.
- The "actual cost" of the coverage (including the first \$50,000) is also taxable for "key employees" covered by any discriminatory plan, as defined by Section 79 of the Internal Revenue Code.
 - The "actual cost" is defined as the greater of:

- The average rate per thousand charged for the entire group (or actual cost allocated, according to employee age if your plan is step-rated), or
- The rate per thousand according to Table I (see attached).
- A “key employee” is defined as an employee who at any time during the current plan year is:
 - An officer, if annual compensation from the employer (or the employer’s subsidiary or affiliate) is greater than \$160,000 for 2009 and 2010.
 - An owner of more than 5 percent of the employer (or the employer’s subsidiary or affiliate).
 - An owner of more than 1 percent of the employer if annual compensation from the employer (or the employer’s subsidiary or affiliate) is greater than \$160,000 for 2009 and 2010 (not indexed annually).

Note that the determination of a “key employee” for the Section 79 nondiscrimination rules uses data from the current testing year rather than the prior year (this is different than other benefit testing that you may also be doing).

The actual cost that is taxable is not subject to income tax withholding but is subject to FICA withholding. If you are not withholding FICA on an ongoing basis, you may wish to withhold the appropriate FICA amount due from any terminated employee’s last paycheck. For purposes of determining the taxable amount pursuant to the Table I rates, the age of the employee is the attained age on the last day of the employee’s taxable year.

Employee-pay-all supplemental group term life insurance plans where some employees pay less than Table I rates for their coverage while other employees pay more than Table I rates will be subject to the same discriminatory plan rules under Section 79, which could result in imputed income to employees for coverage in excess of \$50,000

IRS Table I Rates

All rates are per \$1,000 of coverage per month
*Attained age on the last day of the taxable year

| Age Band | Under 25 | 25-29 | 30-34 | 35-39 | 40-44 | 45-49 | 50-54 | 55-59 | 60-64 | 65-69 | 70+ |
|----------------|----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Table I Rates* | \$0.05 | \$0.06 | \$0.08 | \$0.09 | \$0.10 | \$0.15 | \$0.23 | \$0.43 | \$0.66 | \$1.27 | \$2.06 |

Disability Benefits

Short-term and long-term disability benefits provided by a disability plan where the premium payments are solely from employer contributions are subject to federal and state (where applicable) income tax and may be subject to FICA and FUTA taxes for up to six months after the disability. However, if employees contribute to the cost of these plans after-tax, a portion of any disability benefits received is excludable from income based on the ratio of employee and employer contributions during a three-year look-back period. (Note that premiums paid by employees on a pre-tax basis under a cafeteria plan are considered to be employer contributions).

If the ratio used to determine excludable benefit payments has changed from the previous year, the new calculation and the new ratio must be communicated to your insurer so that the correct amount of income tax withholding, FICA, and FUTA will be determined for any future benefit payments.

If you have any general questions about whether your group health and welfare plan coverage or benefits are taxable to your employees, please contact our office at (770) 424-5777 or (888) 517-3659.

This is not intended to be and should not be relied upon as a complete or thorough discussion of the tax effects of health and welfare plans. Specific questions should be addressed to your tax consultant and/or attorney.