



Health Reform Bulletin #1

Subject: IRS Guidance: Tax-Favored Status of Dependent Coverage
Date: April 28, 2010

As promised, the government is feverishly attempting to issue guidance on the new health care reform law. Yesterday, the IRS issued guidance relating to the tax-favored status of dependent coverage (IRS [Notice 2010-38](#)). Part of the Reconciliation law (enacted March 30th) provides that reimbursement of health expenses for dependent children who have not attained age 27 by the end of the taxable year (calendar year) is excludable from the employee's income. For this purpose, a dependent includes:

- A son, daughter, stepson, or stepdaughter of the employee; and
- A legally adopted child, a child placed for adoption, or an eligible foster child.

This Notice clarifies that this exclusion applies to reimbursements, as well as employer premium paid for dependent coverage. This pronouncement clarifies that the tax-favored status applies to employment taxes as well as income taxes. Further, it provides that coverage for these dependents can be purchased on a pre-tax basis through a cafeteria plan, and that their medical expenses can be reimbursed from a flexible medical spending account, as soon as a health plan is amended to provide coverage for older-aged dependents. It further provides that if older-aged dependents are currently on the plan, the tax-favored status is effective on and after March 30, 2010.

With regard to cafeteria plans, the Notice provides that the older-aged dependent coverage can be allowed retroactive to March 30th as long as the cafeteria plan is amended by December 31, 2010, with a retroactive effective date coincident with the date the cafeteria plan covers the older-aged dependents. Further, the pronouncement clarifies that a status change would be permissible for the treatment of these older-aged dependents. If it is the intent of the plan to cover these older-aged dependents, it is very important to review, and amend accordingly, the health plan, the cafeteria plan, and flexible medical spending account, if applicable.

Several examples included in the Notice make it clear that the marital status of the dependent does not negate the tax-favored status of the benefit. While the new law does not require coverage for the spouse or children of the older-aged dependents, if the plan does extend coverage to such individuals, the Notice makes it clear that the cost of coverage for the older aged-dependent's spouse or child is includible in the employee's income.

In addition, this Notice provides similar treatment of dependents for purposes of VEBAs, retiree health benefits through an IRC Section 401(h) plan, and for self-employed individuals.