

Wisconsin Legislation to Exclude Certain Health-care Benefits from Wisconsin Taxable Income

October 5, 2011

On October 5, 2011, Tax Executives Institute submitted the following comments to key leaders of the Wisconsin legislature, endorsing legislation to conform Wisconsin's tax law to federal provisions relating to the income tax exclusion for employer-provided health care insurance, which were changed by the 2010 health care reform law. The comments, which took the form of a letter from TEI President David M. Penney, were prepared under the aegis of TEI's State and Local Tax Committee, whose chair is Linda H. Dickens of Texas Instruments Incorporated. Contributing substantially were two members of the Wisconsin Chapter — Victor Ledesma of Kimberly-Clark Corporation and Carita R. Twinem of Spectrum Brands, Inc. Daniel B. De Jong, TEI Tax Counsel, serves as legal staff liaison to the State and Local Tax Committee and coordinated the preparation of the comments.

As president of Tax Executives Institute, I write to express the Institute's support for legislation to conform provisions of the Wisconsin Tax Code to recent federal legislation that excludes from an employee's taxable income employer-provided health insurance benefits for adult children under the age of 27. Significantly, Wisconsin is the only state that has not updated its laws in this manner. In addition to increasing the tax burden on Wisconsin residents, failure to enact this legislation will impose severe administrative burdens on Wisconsin employers. We urge prompt action to resolve this matter.

Tax Executives Institute was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 56 chapters in the United States (including two in Wisconsin), Canada, Europe, and Asia. Our 7,000 members represent 3,000 of the largest companies in the world, many of which either are resident or do business in Wisconsin. As the preeminent association of business tax professionals worldwide, TEI has a significant inter-

est in encouraging uniform and equitable enforcement of the tax laws and reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. The Institute is committed to maintaining a system that works — one that builds upon the principle of voluntary compliance and is consistent with sound tax policy.

In 2010, Congress passed the Patient Protection and Affordable Care Act, Public Law 111-149, and the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (together referred to as the "Affordable Care Act"), which expanded the longstanding exclusion from taxable income for employer-provided health insurance coverage and medical flexible spending accounts effective January 1, 2011. The new rules exclude from workers' income employer-paid health insurance premiums and medical flexible spending account (FSA) payments attributable to non-dependent children of covered employees under 27 years of age; this exclusion applies regardless of the covered children's income level, residence location, or whether the employee provides

any or all of their support. Since Wisconsin does not automatically conform its tax statutes to these provisions of federal law, the legislature must enact legislation specifically providing relief (i.e., specifically conforming to these federal laws). Unless and until that happens, Wisconsin will be the only state to impose its income tax on employer-provided health benefits provided in respect of non-dependent children under the age of 27.

Employers would incur significant costs in dealing with Wisconsin's non-conformity with federal law, specifically, in reporting the additional taxable amounts on their employees' Forms W-2. This is no simple task. Generally, employers that offer health insurance to their workers pay one of three amounts:

1. One amount for a single person;
2. Another for a married couple; and
3. Still another for a family plan.

The price for family coverage generally does not depend on the number of children in the family; that is to say, the cost for

providing insurance for a family of three is generally the same as the cost for a family of seven. Moreover, the cost does not depend on the age of the covered individuals (and whether or not they are “dependents” under the tax law). This makes it difficult to accurately calculate the value of health insurance on a per person basis for employees granted coverage under a family plan.

Even assuming a calculation could be done, tracking the necessary data would require obtaining information from employees that employers may not currently collect or at least do not store in a manner allowing for easy incorporation into a calculation meant to place a value on health insurance on a per person basis. Moreover, the information necessary to establish a covered individual’s status as a “dependent” for tax law purposes — and, hence, the taxability of the coverage — could well change after the insurance coverage is provided (and its value is subject to withholding). Until legislation is adopted by Wisconsin to conform to federal law, Wisconsin will remain the only state where employers need to track this data for tax purposes and perform these additional calculations.

This gap in conformity also complicates the administration of FSA programs. Isolating transactions running through an FSA account attributable to expenses incurred by a non-dependent adult child under the age of 27 would necessitate changes to existing FSA management systems. Complicating matters further, many companies outsource administration of their FSA programs to third party service providers. Supplying those third parties with the data necessary to comply with these rules could require intrusive transfers of employees’ personal information. The

added cost of forcing these process changes on businesses to achieve compliance in this area should not be minimized, especially for businesses already straining against existing economic headwinds.

The Wisconsin Department of Revenue has issued guidance to assist taxpayers in complying with the gap between federal and state law. Regrettably, that guidance is unhelpful as it simply states that “[t]he fair market value of the adult child’s health coverage is determined by the employer and insurance provider.” With that, the Department recommends that affected employees contact their employers for further information since “[t]he Department of Revenue cannot determine the fair market value of the coverage.” As explained above, neither can employers.

Given the difficulties of ascertaining the fair market value of these insurance benefits, and the system changes necessary to track FSA transactions attributable to non-dependent adult children under the age of 27, TEI cannot help but conclude that the Department of Revenue would struggle mightily when it comes time to audit returns containing these amounts.

This increased reporting burden, and related uncertainties on audit, will make Wisconsin a less competitive place for businesses, especially since it would be the only state to impose the burden. Businesses faced with deciding where to locate new investments would certainly take into account the increased compliance costs of managing their workforce in compliance with these rules. It is not only businesses that stand to lose if legislation is not passed. Wisconsin workers would also see their pay checks reduced by amounts withheld on

these expanded health insurance benefits. As most employers have not yet begun to withhold on these amounts, employees will see significant and unexpected reductions in their December take home pay as employers catch up by increasing withholding just before the end of the year.

To level the competitive playing field, and relieve employers from a costly and burdensome new reporting requirement, TEI urges the Wisconsin legislature to pass legislation conforming Wisconsin law to the provisions of the Affordable Care Act excluding health insurance coverage and FSA reimbursements for adult children under the age of 27 from the taxable income of Wisconsin-based employees effective January 1, 2011 (the effective date of the federal law). The revised fiscal estimates for legislation fixing this issue show that the cost to the state would be \$1.8 million. Certainly, the state must manage its finances with care, but the relatively small price tag associated with this legislation pales in comparison to the benefits conformity to the relevant provisions of the Affordable Care Act would create for Wisconsin employees, employers, and the general business climate of the state.

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If you have any questions about the Institute’s views or desire additional information regarding the comments contained in this letter, please do not hesitate to contact Linda Dickens, Chair of TEI’s State and Local Tax Committee, at 214.479.1009 (linda-dickens@ti.com) or Daniel B. De Jong of TEI’s legal staff at 202.638.5601 (ddejong@tei.org).