

## Personal Income Tax

### Directive 09-2

#### Massachusetts Department of Revenue

#### Personal Income Tax Treatment of Employer-Provided Health Insurance Coverage for an Employee's Former Spouse

Introduction: This Directive follows TIR 07-16, Personal Income Tax Treatment of Employer-Provided Health Insurance Coverage for an Employee's Child, in discussing another area where Massachusetts insurance statutes require employer-provided health insurance coverage for individuals who are not the spouse or dependent of an employee as defined for purposes of the exclusion of the benefit from gross income under § 106 of the Internal Revenue Code.

Issue: If federal imputed income results from the legally required provision of health insurance coverage to an employee's former spouse, may that income be deducted from Massachusetts gross income under G. L. c. 62, § 2(a)(2)(Q)?

Directive: For taxable years beginning on or after January 1, 2007, to the extent that the coverage is required under Massachusetts statutes such as G. L. c. 176G, § 5A, any federal imputed income that results from the provision of health insurance coverage to an employee's former spouse may be deducted from Massachusetts gross income under G. L. c. 62, § 2(a)(2)(Q).

Discussion:

## Federal Income Tax

Section 61(a)(1) of the Internal Revenue Code (the Code) states that, except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. A fringe benefit is any property or service that an employee receives in lieu of or in addition to regular taxable wages. The extent to which a particular fringe benefit is excluded from gross income depends on the Code provisions that apply to the benefit.

Employer-provided health insurance coverage is a fringe benefit. Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan. Section 1.106-1 of the U.S. Treasury Regulations expands the exclusion by providing:

The gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in section 152.

In addition, for purposes of the exclusion at Code § 106 for employer-provided health coverage, Internal Revenue Service Notice 2004-79, 2004-2 C.B. 898, has expanded the definition of dependent at Code § 152 to eliminate the gross income limit at Code § 152(d)(1) for a "qualifying relative". The Internal Revenue Service has further allowed the exclusion from gross income for employer-provided health coverage for retired or laid-off employees, their spouses and dependents and for the surviving spouses or dependents of deceased employees as an extension of the regulations. See e.g., Rev. Rul. 82-196, 1982-2 C.B. 53, and Rev. Rul. 85-121, 1985-2 C.B. 57.

On August 6, 2007, the Internal Revenue Service issued new proposed regulations providing guidance on cafeteria plans under section 125 of the Code. The proposed regulations generally indicate that they apply on and after plan years beginning on or after January 1, 2009. Section 1.125-1(h)(2) and (3) of the proposed regulations specifically addresses the tax treatment of health coverage purchased for someone other than the employee's spouse or dependents. It provides as follows:

If the requirements of section 106 are satisfied, employer-provided accident and health coverage for an employee and his or her spouse or dependents is excludible from the employee's gross income. The fair market value of coverage for any other individual, provided with respect to the employee, is includible in the employee's gross income.

§ 1.106-1; § 1.61-21(a)(4), and § 1.61-21(b)(1). A cafeteria plan is permitted to allow employees to elect accident and health coverage for an individual who is not the spouse or dependent of the employee as a taxable benefit.

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Example. Accident and health plan coverage for individuals who are not a spouse or dependent of an employee. (i) Employee C participates in Employer M's cafeteria plan. Employee C timely elects salary reduction for employer-provided accident and health coverage for himself and his former spouse. C's former spouse is not C's dependent.

(ii) The fair market value of the coverage for the former spouse is \$1,000. Employee C has \$1,000 includible in gross income for the accident and health coverage of his former spouse, because the section 106 exclusion applies only to employer-provided accident and health coverage for the employee or the employee's spouse or dependents.

Proposed Treas. Reg. § 1.125-1(h)(2) and (3).

Valuation of Imputed Income is a Question of Federal Law. For federal income tax purposes, an employee whose employer-provided health insurance covers a former spouse who is not a dependent of the employee will be taxed on the fair market value of the former spouse's coverage to the extent that it exceeds any amount paid by the employee on an after-tax basis (employee pre-tax contributions are considered to be employer contributions). An employer will determine the amount of imputed income attributable to the health insurance coverage of an employee's former spouse under valuation principles articulated in federal income tax law.

#### Massachusetts Personal Income Tax

Massachusetts gross income is federal gross income, as defined under the Code, with certain modifications. G.L. c. 62, § 2(a). Generally, with respect to the personal income tax, Massachusetts adopts the Code as amended and in effect on January 1, 2005. G.L. c. 62, § 1. Massachusetts follows IRC § 106 as amended and in effect on January 1, 2005, whereby employer-provided health and accident premiums are excluded from the gross income of an employee, as long as the benefits are for the employee, the spouse or the dependents of the employee, which terms have been expanded as described above.

Since the value of employer-provided health insurance benefits for an employee's former spouse who is not the employee's dependent may be included in the employee's federal gross income under IRC § 106, in the absence of other provisions, it would likewise be included in the employee's Massachusetts gross income because Massachusetts follows the Code. G. L. c. 62, § 2(a).

Effective for taxable years beginning on or after January 1, 2007, General Laws chapter 62, § 2(a)(2)(Q) provides that the following item must be deducted from Massachusetts gross income:

If an employee participates in an employer-provided health insurance plan, any amount which, but for this section, would be included in gross income of

the employee by reason of coverage under the plan of any person other than the employee, to the extent such coverage is mandated by law.

Massachusetts insurance laws traditionally have required employer-provided health insurance plans to cover former spouses of employees under various circumstances. For example, G. L. c. 176G (Health Maintenance Organizations), § 5A provides:

(a) In the event of the granting of a judgment absolute of divorce or of separate support to which a member of a group health maintenance contract is a party, the person who was the spouse of said member prior to the issuance of such judgment shall be and remain eligible for benefits under said contract, whether or not said judgment was entered prior to the effective date of said contract, without additional premium or examination therefore, as if said judgment had not been entered; provided, however, that such eligibility shall not be required if said judgment so provides. Such eligibility shall continue through the member's participation in the contract until the remarriage of either the member or such spouse, or until such time as provided by said judgment, whichever is earlier.

(b) In the event of the remarriage of the member referred to in paragraph (a), the former spouse thereafter shall have the right, if so provided in said judgment, to continue to receive benefits as are available to the member, by means of the addition of a rider to the family contract or the issuance of an individual contract, either of which may be at additional premium rates determined by the commissioner of insurance to be just and reasonable in accordance with the additional insuring risks involved.

For other examples, see, e. g., G. L. c. 32A, § 11A, c. 175, § 110, c. 176A, § 8F and c. 176B, § 6B.

Thus, because Massachusetts insurance laws such as G.L. c. 176G, § 5A(a) require continued health insurance coverage for a former spouse of an employee with employer-provided health insurance until the remarriage of either person unless the judgment of divorce provides otherwise, for taxable years beginning on or after January 1, 2007, G.L. c. 62, § 2(a)(2)(Q) operates in all such cases to deduct from Massachusetts gross income any gross income imputed federally. The deduction from Massachusetts gross income under G.L. c. 62, § 2(a)(2)(Q) also applies to employees with coverage under self-funded or self-insured employer-provided health plans adopting health insurance coverage of a former-spouse otherwise required for insured plans under the applicable Massachusetts insurance statutes.

/s/ Navjeet K. Bal  
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