

Date: November, 2008

To: Iowa Bankers Benefit Plan Health Plan Administrators

From: Chris Wehde, Vice-President

RE: Extension of Dependent Eligibility

Earlier this year legislation was enacted in Iowa requiring group health plans subject to state regulation to expand their definition of "dependent" to continue coverage for unmarried dependents that reside in the State of Iowa and have either not reached the age of 25 or remain a full-time student. Although we sent out information regarding this new regulation in July of 2008, we wanted to share with our participating employers more specific information regarding compliance with this new state law.

The Iowa Bankers Benefit Plan will be implementing the new law's requirements effective January 1, 2009. Although the law does not require us to add previously dropped dependents that are now eligible, we will allow dependents who were previously dropped from the plan to be added back on the plan effective January 1, 2009 if they meet the new eligibility criteria and the employee chooses to add them. If the employee chooses not to add a dependent that was previously dropped due to the fact they were no longer eligible under the Plan January 1, 2009 and then choose to add the dependent at a later date, standard eligibility rules will apply.

You should also be aware that there are important tax ramifications to employees who choose to allow their dependents to continue on the plan in accordance with the new law. The Iowa Insurance Division has issued a fact sheet that states that if a child that is covered does not meet the definition of a dependent for federal income tax purposes; the value of the cost of covering that child is considered additional taxable income to the employee. The definition of "dependent" utilized by the Internal Revenue Service has not changed. In order for health insurance premiums paid by or on behalf of an employee to be excludable from the employee's gross income, they must only cover the employee, the employee's spouse and qualifying dependents.

A qualifying dependent is someone who meets the definition of "qualifying child" or "qualifying relative". If an employee's child meets either definition, the premiums paid toward the child's coverage may continue to be pre-taxed and any employer contributions toward the child's premiums will not be taxable to the employee. However, if the child does not meet either definition then the value of the health insurance provided to the child is taxable to the employee. This means that the employee's contribution toward the child's coverage must be paid with after-tax dollars. In addition, an employer's contribution toward the employee's premium could also be taxable income to the

employee to the extent it results in the employee paying less than the fair market value for the child's coverage.

The Internal Revenue Code defines a "qualifying child" to include a child who meets the following criteria:

- bears a relationship to the taxpayer;
- has the same principal place of abode as the taxpayer for more than one-half of the taxable year;
- has not attained the age of 19 or 24 if the child is a student, as of the close of the calendar year; and
- has not provided over one-half of their own support for the calendar year.

Children who are permanently and totally disabled are treated as having met the above criteria.

Children who do not qualify as a child could still be a "dependent" if they are considered a "qualifying relative" meaning that in addition to being the child of the employee they have over one-half of their support provided by the employee in the calendar year.

If you have an employee who wishes to add a child who does not meet the definition of a "qualifying child" or "qualifying relative" and is not a tax dependent, you should require the employee to pay the fair market value of the dependent's coverage with after-tax dollars. In addition, if the employee pays less than the fair market value of the dependent's coverage because of an employer contribution, the difference between the fair market value of the dependent's coverage and what the employee pays will be considered taxable income to the employee. What is the fair market value? The **single premium** for the plan at issue should be used as the fair market value of the dependent's coverage since it represents the cost to cover one individual.

While some employers may be tempted to ignore the tax ramifications, doing so could have important tax consequences to your employees. Additionally, it could jeopardize your cafeteria plan to the extent you are pre-taxing contributions made on behalf of a non-tax dependent.

We are advising all of our employers to contact their tax advisors as to how to proceed with compliance for this new state regulation. To assist you with administering these tax issues, we have prepared a general notice to explain the new regulation and a form which can be completed by your employees who have dependents affected by this new law. We have also placed on our website the memo we sent out in July plus additional tax information. All this information is located out on our website at [www.bankers-insurance.com/IBBP administration](http://www.bankers-insurance.com/IBBP_administration). If you have further questions, you may contact Chris Wehde at 1-515-286-4205.

Thank you for your cooperation!