



## Legislative Fiscal Bureau

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TO: Members  
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 277 and Senate Bill 203: Individual Income Tax Exclusion for Employer Medical Care Payments for an Employee's Adult Child

Assembly Bill 277 and Senate Bill 203 are identical bills that would provide a state individual income tax exclusion for certain payments made by an employer to an employee to reimburse the employee for costs incurred for medical care of the employee's adult child to the extent that those payments and costs are referenced under specified sections of Public Law 111-152 and the Internal Revenue Code (IRC).

Both bills were introduced on September 27, 2011, and referred to committee. AB 277 was referred to the Assembly Committee on Insurance, which held a public hearing on the bill on October 5 and has an executive session scheduled on October 11. SB 203 was referred to the Joint Survey Committee on Tax Exemptions, which has scheduled a public hearing and executive session on the bill on October 11.

### **CURRENT LAW**

State individual income tax provisions are generally referenced to definitions under federal law. Changes to federal law take effect for state tax purposes only after action by the Legislature. Each biennium, the Legislature typically reviews federal law changes from the prior two years to update state references to the IRC. As a result of changes made by 2011 Wisconsin Act 32 (the 2011-13 biennial budget act), the current state statutes refer the federal IRC in effect on December 31, 2010, although there are a number of exceptions where federal law changes have not been adopted.

Employer-provided health insurance benefits for employees and employees' spouses and dependents are excluded from gross income for federal and state income tax purposes. As of March

30, 2010, the Affordable Care Act extends this treatment to employees' non-dependent children who are 26 years of old or younger for the entire calendar year. Wisconsin has not adopted this treatment. Consequently, employees who elect to have their non-dependent children covered under their employer-provided health insurance are subject to state tax on the part of the benefit's value that is attributable to the nondependent child. The fair market value of the adult child's health coverage is determined by the employer and its insurance provider. Also, the Affordable Care Act allows employees to use their medical flexible spending accounts to reimburse the eligible medical expenditures of their nondependent children. However, such a reimbursement may not be excluded from income for state tax purposes. In such instances, employers are required to report that income as taxable for state tax purposes on the employee's W-2 statement or the employer must issue a Wisconsin-only W-2 for the employee.

## **SUMMARY OF BILLS**

AB 277 and SB 203 would federalize Wisconsin's state income tax treatment of employer-provided health insurance and flexible spending account as those payments relate to an employee's non-dependent child under the age of 27. The treatment would apply retroactively to January 1, 2011, so the change would cover all of tax year 2011.

## **FISCAL EFFECT**

The Department of Revenue estimates that adopting these provisions of the Affordable Care Act would reduce state individual income tax revenues by \$1.8 million annually. The bills would apply retroactively to January 1, 2011. As a result, the fiscal effect for 2011-12 would include the entire effect for tax year 2011 (-\$1.8 million) and half the effect for tax year 2012 (-\$0.9 million). Therefore, the bills would reduce state revenues by \$2.7 million for 2011-12 and \$1.8 million for 2012-13, or by \$4.5 million for the 2011-13 biennium.

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