



**City of Seattle Equal Benefits Program
Contractor Compliance Guidelines
Taxation**

FACT SHEET

This Fact Sheet explains the basic tax issues employers should consider when implementing a domestic partner health benefits policy.

What are the tax differences between health care benefits for spouses and domestic partners?

When employers provide health care benefits for the spouse and/or dependents of their employees, the Internal Revenue Code allows the money paid by the employer for these benefits to be excluded from the employee's gross income. (Internal Revenue Code §§105, 106.) No such exclusion exists for benefits given to an employee for his or her domestic partner, or the dependents of a domestic partner. Therefore, the money paid by an employer for health care benefits for an employee's domestic partner and/or the dependents of a domestic partner is income that is taxable.

Who is responsible for paying the tax?

The employee is responsible for paying the tax on domestic partner benefits. To the extent the law requires the employer to withhold tax on the income paid to its employees, the tax on domestic partner benefits must also be withheld.

How is the tax calculated?

While there is no Internal Revenue Service (IRS) code specifically addressing this issue, private letter rulings issued by the IRS require that an employer withhold tax from their employees' income on the fair market value of the health benefit paid in excess of the amount paid by the employee for that benefit. For example, at XYZ Co., the cost of the health insurance premium for a domestic partner is \$50.00 per month. The employee pays \$30.00 of this premium, and the employer pays \$20.00. The fair market value to be included in the employee's gross income would be \$20.00, which equals the cost of the premium minus the amount paid by the employee. This is called imputed income. Where the premium rate is difficult to determine, for example where an employer is self-insured, the fair market value may be determined by using the COBRA rate minus any administrative fees.

Can the tax on benefits given to domestic partners be avoided where a domestic partner is considered a dependent for purposes of the tax laws?

Yes. A domestic partner may be considered a dependent for purposes of the tax laws governing employer-provided health care benefits if the domestic partner is recognized as a common-law spouse, or where the domestic partner meets the following criteria: (1) the domestic partner receives over 50% of his or her support from the taxpayer; (2) the domestic partner's principal place of abode is the taxpayer's home; and (3) the domestic partner is a member of the taxpayer's household. (Please note that a domestic partner cannot be a member of the taxpayer's household if the relationship is in violation of local law.) Where a domestic partner is considered a dependent, the money paid by the employer for health care benefits can be excluded from the employee's gross income.

Can the tax on benefits given to children of domestic partners also be avoided?

If the children of a domestic partner satisfy the requirements of being a dependent (as outlined above), the money paid by the employer for their health care benefits can be excluded from the employee's gross income. (This assumes that the domestic partner's children have not been adopted by the employee.)

What about other taxes, such as FICA and FUTA?

To the extent that the fair market value of domestic partner benefits is considered taxable as income, it also will be treated as wages subject to inclusion in Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) tax calculations.

Can employers deduct the cost of providing domestic partner benefits along with other forms of employee compensation?

Yes. The corporate tax deductions allowed for other benefit plans also are available to employers providing domestic partner benefits. This is because Internal Revenue Code section 162(a) allows employers to deduct all "ordinary and necessary business expenses" associated with employee compensation and does not specify to whom the benefit must be paid in order for the deduction to apply.

The information contained in this document is not intended as legal advice and should not be relied on as such.