

California Adopts Retroactive Conformity to Federal Exclusion from Gross Income for Adult Children Health Benefits

by Lori Partrick and Christine L. Richardson

In states that have not conformed, or do not automatically conform, to the Internal Revenue Code changes made by the Patient Protection and Affordable Care Act (“PPACA”), the value of health benefits provided to adult children may be considered income for state income tax purposes unless the child also meets the applicable state definition of a tax dependent. California has now enacted conforming legislation, retroactive to the effective date of PPACA, making the federal income exclusion applicable for California state income tax purposes and thus eliminating the need to report imputed income for adult children’s benefits.

As reported in our client alert dated [January 13, 2011](#), the value of employer-provided health benefits provided to any child who is under the age of 27 at the end of the taxable year is excluded from gross income for federal income tax purposes, regardless of whether the child qualifies as the employee’s “tax dependent” under the Internal Revenue Code. However, the tax treatment of such benefits for state income tax purposes will depend on whether the particular state conforms to the Internal Revenue Code as in effect when the PPACA amendments to the Internal Revenue Code became effective.

Internal Revenue Code Section 105(b) generally excludes from gross income the value of employer-provided benefits under a health plan. As a “selective conformity” state, California needed to enact legislation adopting the PPACA amendments for the income exclusion to apply for state income tax purposes when benefits are provided to a child who is not the employee’s tax dependent under California law. Legislation to make California tax law conform to federal law with regard to adult children was introduced during the 2010 legislative session, but the bill failed to pass. In the absence of conforming legislation, California employers providing health benefits to adult children have been wrestling with how to track the status of such adult children and the accompanying imputed income issues.

California tax conforming legislation was reintroduced in 2011 as Assembly Bill 36. The bill easily passed in both the Assembly and Senate, and was signed into law by Governor Brown on April 7, 2011. A.B. 36 provides for retroactive tax conformity with PPACA regarding the gross income exclusion for adult children. The PPACA amendments and hence A.B. 36 became effective on March 23, 2010. Accordingly, employers who reported W-2 income for California state income tax purposes based on health benefits provided to adult children during 2010 should issue amended W-2 forms to affected employees. Employers can refer to the Employment Development Department website at www.edd.ca.gov for guidance, which should soon be forthcoming on how to amend 2010 reported information. Employees may correct their wage statements by filing Form 540X, available at www.ftb.ca.gov/forms/2010/10_540x.pdf, with the California Franchise Tax Board.

Similar state tax code amendments are in process in other states.

For more information on PPACA, see our client alerts dated [March 30](#) and [May 13](#) and [September 8](#) and [September 9, 2010](#) and our white paper dated [July 12, 2010](#).

If you have any questions about the alert, please contact the Pillsbury attorney with whom you usually work or one of the members of our Executive Compensation & Benefits practice section.

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