

Law Amends Federal Definition of Dependent

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Before his departure from office, President Bush signed legislation, known as the Fostering Connections to Success and Increasing Adoptions Act of 2008 (the "Act"). Although the Act primarily makes changes to the Social Security Act relating to adoptions and foster care, the Act also revises Section 152(c) of the Internal Revenue Code (the "Code"), the portion of the Code that defines "qualifying child" for purposes of the federal definition of dependent. **The Act became effective January 1, 2009.**

Why We Care. The definition of qualifying child found in Section 152(c) of the Code is relevant in determining whether: (1) providing medical, dental, or vision coverage to a child is taxable to the employee, (2) expenses incurred by a child may be reimbursed under a health flexible spending account ("FSA") or a health reimbursement arrangement ("HRA"), (3) expenses incurred by a child may be reimbursed on a tax-free basis from a health savings account ("HSA"), and (4) a child is a "qualifying individual" for purposes of a dependent care FSA.

The Changes. The legislation makes three changes to Code Section 152(c):

1. **Child Must Be Younger Than Taxpayer.** Currently, a qualifying child generally must be under age 19 or be a student under age twenty-four (24) at the end of the calendar year to be considered a qualifying child for that year. Under the amended Section 152(c), a child must be younger than the taxpayer to be the taxpayer's qualifying child.

Child Must Not File Joint Tax Return. Under the amended Section 152(c), a child who files a joint federal income tax return with his or her spouse cannot be a qualifying child. Accordingly, most married children can no longer be a qualifying child.

Note: Currently, Section 152 generally provides that an individual who files a joint federal income tax return with his or her spouse cannot be another person's dependent. However, for purposes of most benefit plans, that requirement does not apply. In light of the amendment made by the Act, the requirement will now be applicable for determining whether a child is a tax dependent for benefit plan purposes under the qualifying child piece of the definition. However, it is still not applicable for determining whether a child is a tax dependent for benefit plan purposes under the qualifying relative piece of the definition.

2. **Special Rule Where Multiple Individuals May Treat Child As Dependent.** Generally, if a child may be considered the qualifying child of both the child's parent and a nonparent, only the parent may treat the child as a qualifying child. The Act changes that rule. A child may be treated as the qualifying child of a nonparent if: (1) no parent claims the child as a qualifying child, and (2) the nonparent has a higher adjusted gross income than any parent of the child.

Action Items. In light of the Act, we recommend the following actions be taken:

1. Review and, if necessary, revise any forms or descriptive materials being used for the purpose of identifying whether children covered under your medical, dental, or vision plans are tax dependents.
1. Note: Hitesman and Associates have revised their standard Certification of Dependent Status form, which can be found on their website www.hitesmanlaw.com.
2. Review and revise group health plan (e.g., medical, dental, and vision plans), health FSA, and HRA documentation to accurately describe which individuals are dependents for tax purposes.
3. Review and revise dependent care FSA documentation to accurately describe which individuals are "qualifying individuals" for purposes of dependent care FSAs.
4. If a high deductible health plan is offered with an HSA, review any descriptive materials distributed to employees about HSA distributions to ensure they accurately describe which individuals are dependents for whom tax-free distributions may be taken.

Because the definition change may impact employees' coverage elections for plans beginning January 1, 2009, Hitesman and Associates recommend these items be reviewed immediately.

If you have any questions regarding the final regulations or need assistance with any of the action items, contact Darcy Hitesman, Hitesman and Associates, www.hitesmanlaw.com.

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