

Benefit Fact Sheet

What is it?

The Working Families Tax Relief Act (WFTRA) was enacted to create a consistent definition of a dependent under various sections of the tax code. WFTRA redefined which dependents are eligible to participate in employer sponsored benefit plans on a pre-tax basis. This had the unintended consequence of significantly changing dependent eligibility for pre-tax benefits. Since the initial enactment, the federal government and the IRS have issued technical corrections to eliminate this unintended consequence. WFTRA now has no impact on employee benefit plans in the vast majority of situations.

Objective

To create a consistent definition of a dependent for tax purposes.

Why offer it?

Federal law permits the cost of dependent coverage to be provided on a tax-favored basis if dependents meet the requirements under WFTRA, beginning January 1, 2005.

Who offers it?

All employers and employees are subject to WFTRA.

What are the provisions of the law?

WFTRA changes the definition of dependent, as defined in Section 152 of the Internal Revenue Code. Section 152 determines which dependents can be claimed on an employee's tax return and are eligible to participate in a tax-favored manner under certain employee benefit plans.

While the revised definition does not prevent dependents from participating in most employee benefit plans, it does affect the taxability of the benefits. Only dependents that meet the Section 152 requirements are eligible to receive reimbursement on a pre-tax basis for plans such as healthcare and dependent care spending accounts. In order to meet the Section 152 eligibility requirements, a person must be considered either a qualifying child or a qualifying relative.

A qualifying child is someone who:

1. Relationship: Is considered a "child" of the taxpayer (child, sibling, step-sibling, or descendent);
2. Residency: Has had the same principal residency as the taxpayer for more than one-half of the year;
3. Support: Does not provide more than one-half of his or her own support during the year; and
4. Age: Has not attained the age of 19, or age 24 if a full-time student by the end of the year. There is no age limit for totally and permanently disabled children.

A qualifying relative is someone who:

1. Relationship: Is related to the taxpayer (child, grandchild, sibling, step-sibling, parent, step-parent, aunt, uncle, first cousin, in-law, court appointed such as an adopted or foster child, or someone who resides in the taxpayer's house);
2. Income: Has a gross income for the calendar year of less than the exemption amount of \$3,650;
3. Support: Does not provide more than one-half of his or her own support during the year; and
4. Status: Is not a qualifying child of the taxpayer or of "any other taxpayer".

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IRS guidance has provided two exceptions to the qualifying relative tests:

- The Status test does not apply if “any other taxpayer” is not required to file a tax return based on Section 6012. To claim this exception, “any other taxpayer” must not file a tax return or only file a tax return to receive a refund of withheld taxes.
- The Income test does not apply for accident and health plans if an individual meets all of the requirements for being a “qualifying relative” except the income limit (even though he or she is not a “dependent” under the definition in Code Section 152). The Gulf Opportunity Zone Act extended this same exception to health savings accounts (HSAs) and dependent care FSAs retroactive to January 1, 2005.

What are the employer’s responsibilities?

- Review Section 125 plan documents that define the eligibility of dependents, and make any necessary changes. The documents should explain that only those individuals that are eligible to participate on a pre-tax basis are included in the plan. You do not need to make these changes to your plan documents if they currently generically refer to Section 152 and Section 21 (as modified by Section 105(b), Section 125(e)(1)(D), and Section 129(c)(2) as applicable). These documents were automatically updated to include the modified language when the tax code changed.
- Identify individuals that gain or lose eligibility for pre-tax benefits. Employers may consider using election forms that require employees to certify that dependents covered under the benefit plans are qualified as tax dependents. A signed form limits the employer’s liability for improper tax reporting that results from covering ineligible participants under the Section 125 plan.
- Review procedures for communicating the revised requirements to employees. Employers must consider whether an open enrollment opportunity should be permitted for employees to adjust their elections.

Informational Link(s)

- [WFTRA](#) (Internal Revenue Service)
- [WFTRA](#) (Trucker Huss)

This Fact Sheet is designed to provide a general overview of the benefit program, service, or regulatory act it describes. The information included in this document is not a substitute for legal or professional opinion relative to a plan sponsor’s particular fact pattern. Your ArlenGroup consultant can answer more specific questions relative to its application for your organization. A menu of additional topics is available online at: www.arlengroup.com/facts.