

# LEGISLATIVE UPDATE

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## IRS Ruling 2006-36 Who can be a beneficiary under a HRA?

The Internal Revenue Service issued Rev. Ruling 2006-36 which confirms the restriction on designating individuals other than a spouse or a child as beneficiaries of a Health Reimbursement Arrangement (HRA). The IRS reaffirmed that HRAs may only reimburse qualified health care expenses incurred by an employee or retiree, and the employee or retirees' spouse and/or qualified dependent children. HRA plans that allow participants to designate a beneficiary other than the employee or retiree's spouse or qualified dependent children, jeopardize the HRAs tax-exempt status, causing all health care expenses reimbursed by the HRA to employees and/or retirees to be treated as imputed income.

Entities engaging in this practice, especially those offering retiree health care solutions to public sector employers are granted until January 1, 2009 to amend their plans to comply with the provisions in this Notice.

## IRS Notice 2006-86 Guidance on “Tiebreaking” Rule for Two or More Taxpayers Claiming Qualifying Child

### Overview

The tiebreaking rule under Code section 152(c)(4) determines which of two or more taxpayers may claim a qualifying child under the following: (1) child tax credit, (2)

earned income credit, (3) head of household filing status, (4) dependency deduction, (5) dependent care tax credit, and (6) dependent care assistance exclusion. The latter two tax exemptions are most applicable for ABD clients and their plan participants. The tiebreaking rule provides that a child is considered the qualifying child of the taxpayer who is the child's parent; or, if none of the taxpayers is the child's parent, the taxpayer with the highest adjusted gross income. If both taxpayers are the child's parents and do not file a joint tax return, the child is treated as the qualifying child of the parent with whom the child resides for a longer period of time during the year. If the child resides with both parents for the same amount of time, the child is treated as the qualifying child of the parent with the higher adjusted gross income.

The special rule for divorced parents provides that under certain conditions relating to custody and support, the non-custodial parent may claim the child for certain purposes. Specifically, the non-custodial parent may claim the child as a qualifying child if certain residency and support requirements are met and the custodial parent releases the claim to the exemption in a written declaration. This rule applies to those individuals who are divorced, separated under a decree of separation, or have lived apart for the last 6 months of the calendar year.

### Guidance

The IRS in its guidance indicates that when the special rule for divorced parents does not apply, and one or more taxpayers claim a child as a qualifying child, the child is treated as the qualifying child of only one taxpayer for all the purposes set forth above at (1) through (5). In other words, the IRS does not make gradual determinations of who may claim a child as a qualifying child for the above referenced purposes.

As to the special rule for divorced parents, a child may be treated as the qualifying child of two taxpayers inasmuch as the non-custodial parent may claim the child as qualifying child only for purposes of the child tax credit and the dependency deduction. And only the custodial parent may claim the child as a qualifying child for purposes of the head of household status, earned income credit, dependent care tax credit, and dependent care assistance.

**Example:** The father and mother of a child are married to each other. The father, mother, and child share the same residence for the first 8 months of the year. For the last four months, the parents live separately and the child resides with the mother. The parents file separate tax returns. The father claims the child as a qualifying child for purposes of the dependency deduction and the exclusion for dependent care assistance. The mother claims the child for purposes of the dependency deduction, the child tax credit, and the exclusion for dependent care assistance. Under the tie-breaking rule, the child is treated as the qualifying child of the mother because he resided with the mother for the longer period of time during the taxable year. Therefore, the child is the qualifying child for the mother for purposes of the dependency deduction, the child tax credit, and the exclusion for dependent care assistance. The special rule for divorced parents does not apply because the mother

and father are not divorced, separated under a separation agreement, and they did not live apart the last 6 months of the calendar year.

**Note to DCAP Administrators:** It is clear under this guidance that only the custodial parent may take the DCAP exclusion. This may require implementation of certain procedures to verify a participant's qualification to take the dependent care assistance exclusion.

## MEDICARE PREMIUMS AND DEDUCTIBLES FOR 2007

Part A monthly premium: \$410

Part A annual deductible: \$992

Part B standard monthly premium: \$93.50

Part B annual deductible: \$131

Part D- national average monthly premium is \$22 (standard Part D Plan)

The Centers for Medicare & Medicaid Services (CMS) updates the premiums, deductibles, and co-payments made by Medicare beneficiaries each year. These adjustments are made according to formulas set by statute.

As discussed in our September 2006 Legislative Update, beginning in 2007, single beneficiaries with annual incomes over \$80,000 and married couples with incomes over \$160,000 will pay a higher percentage of the cost of Medicare Part B coverage.

Roughly 99 percent of Medicare beneficiaries do not pay a premium for Part A services, since they have at least 40 quarters (10 years) of Medicare-covered employment. Seniors with fewer than 30 quarters of covered employment, and eligible individuals under age 65 with disabilities, may obtain Part A coverage by paying a monthly premium set according to a statutory formula. This premium will be \$410 per month for 2007, an increase of \$17 from 2006. In addition, those seniors with 30 to 39 quarters of covered employment, and eligible disabled persons with 30 or more quarters of covered employment, will pay a premium of \$226 in 2007, compared to \$216 in 2006.

Medicare Part A pays for inpatient hospital, skilled nursing facility, hospice, and certain home health care. Part B pays for outpatient health care expenses including but not limited to physician services and outpatient surgery, and Part D pays for prescription drug coverage.

## MEDICARE PART D ANNUAL NOTICES NOVEMBER 15, 2006 DEADLINE

The annual Medicare Part D open enrollment period (November 15- December 31), is rapidly approaching. As a reminder, employers are required to notify Medicare Part D-eligible participants who receive prescription drug coverage under their plan, whether the plan's coverage qualifies as "creditable" prescription drug coverage.

Employers are required to distribute the Notice(s) on an annual basis to covered plan participants (active employees, retirees, COBRA participants, severed employees, their spouses and children) who are eligible for Medicare or who are covered by Medicare. The Notices must be issued no later than November 15 of each year, unless the employer's prescription drug changes prior to this date.

If your prescription drug coverage has changed or will change on January 1, 2007, be sure to review the benefit coverage to determine whether the plan is a "creditable" or "non-creditable" plan. If the plan is determined to be non-creditable, notices must be provided indicating its non-creditable status. If you are uncertain of the status of your prescription drug plan contact your insurance carrier, prescription drug vendor, or ABD representative for further information.

The Centers for Medicare and Medicaid Services (CMS) updated the model notices of creditable coverage and non-creditable coverage employers should use. Information about the revised notice requirements was discussed our May 2006 Legislative Update. Samples of the revised notices are also available at [www.Cybersure.com](http://www.Cybersure.com).

### FASB 158 – NEW FINANCIAL REPORTING FOR POSTRETIREMENT BENEFITS

The Financial Accounting Standards Board (FASB) issued on September 29, 2006, a new accounting standard, FASB 158, to provide guidance on the method companies should recognize on their annual financial statements, obligations associated with retiree medical plans and defined benefit pension benefit plans. FASB 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, applies to public and private companies and nongovernmental not-for-profit organizations.

FASB 158 amends the disclosure and reporting obligations implemented by FASB 106 in the early 90s', by requiring companies to recognize all transactions that affect the benefit obligations of a retiree plan and report said information in its balance sheet rather than disclose their benefit obligations in the notes of their financial statements.

With the implementation of this new accounting standard, FASB intends to provide investors and creditors with the necessary information to accurately assess an employer's financial position and the employer's ability to satisfy postretirement obligations.

**Compliance Date:** Employers with publicly traded equity securities are required to initially recognize the funded status of their postretirement benefit plans by the end of the fiscal year ending after December 15, 2006. Employers without publicly traded equity securities are required to report their funded status as of the end of fiscal year ending after June 15, 2007.

## STATE DEVELOPMENTS

### DOMESTIC PARTNER UPDATE

**California** *Woo v Lockyer* (128 Cal.App.4th 1030)- July 10,2006

Arguments were held before the California Court of Appeals after a lower court ruled that California could not deny the right to marry to same-sex couples. The Court of Appeal, held that organizations did not have direct and immediate interest in the outcome of consolidated actions, and thus was not entitled to intervene.

**Colorado** Ballot Initiative

On Tuesday, November 7, 2006, Colorado registered voters will determine if the Colorado constitution should be amended to include the Colorado Domestic Partner Benefits and Responsibilities Act . This Act will allow domestic partners to obtain a license to register their domestic partnership. Registration will give same sex domestic partners similar rights and obligations as married spouses, with the exception of the right to file joint income state tax returns and receiving certification of the domestic partnership from any religious official or institution.

**Maryland** *Deane and Polyak v Conaway* (WL 148145 Md.Cir.Ct.,2006)- January 20,2006

A Maryland Circuit Court ruled it is a violation of the state constitution to deny same-sex couples the numerous protections provided to married couples. Circuit Court Judge Brooke Murdock found that denying same-sex couples the ability to marry violates the state constitution's Equal Rights Amendment, which protects against discrimination based on sex.

**Massachusetts** *Goodrich v. Department of Public Health* (440 Mass. 309, 798 N.E.2d 941 Mass.,2003. November 18, 2003)

As a result of the Massachusetts Supreme Judicial Court decision on May 17, 2004 same sex marriage became legal in the state of Massachusetts. Same-sex marriages must be treated in the same manner as opposite-sex marriages for purposes of Massachusetts law.

**New York** *Samuels v. New York State Department of Health, (- N.Y.S. 20 - NY App.Div 2006*-July 6, 2006

The New York Court of Appeals decided to uphold a state law that bars same-sex couples from marriage. This was a surprising ruling considering most of New Yorkers support marriage for committed same sex couples.

## NEW YORK

### LEAVE OF ABSENCE FOR MILITARY SPOUSES

On August 16, 2006, a new state law went in effect allowing spouses of individuals who are in the armed forces up to ten days of unpaid leave upon request.

Employers who employ 20 or more employees in at least one site within the state, including individuals, corporations, counties, towns, cities, school districts, public authorities, or other governmental entities of any kind are covered by the law.

An employee is defined as individual who performs services for hire for an average of 20 hours per week, excluding independent contractors. In addition, the employee must be married to a member of the armed forces of the United State, national guard, or reserves who has been deployed during a period of military conflict to a combat theater or combat zone of operations. A "period of military conflict" is defined as a period of war declared by the United States Congress, or in which a member of a reserve component of the armed forces is ordered to active duty. The leave may only be used when the employee's spouse is on leave from the armed forces during a period of military conflict.

## RHODE ISLAND

### RHODE ISLAND ISSUES NEW TDI RATES

The new maximum weekly benefit for claimants whose benefit year begins on or after July 1, 2006 is \$625. The minimum weekly benefit has been increased to \$66. The new maximum weekly benefit rate applies only to claims established on or after July 1, 2006.

The TDI law also provides for an additional benefit allowance (called a "Dependency Allowance") for employees with dependent children under 18. The allowance may also be paid for a child 18 or older who is physically or mentally handicapped and unable to work. Only natural, stepchildren, legally adopted children or court appointed wards may be claimed as dependents. This additionally benefit is presently set at the greater of \$10 or 7% of the employee's weekly benefit rate for each dependent child, up to a maximum of five dependents. This additional dependent benefit allowance continues unchanged.

For more information on State Disability Insurance in other states, [click here](#).

This Legislative Update is provided for informational purposes only, and must not be construed as legal or tax advice. Please contact your ABD representative to determine how the content of this Legislative Update may impact your employee benefit plans.