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April 15, 2013

The Honorable Diane Black
The Honorable Danny Davis
Tax Reform Working Group on Education and Family Benefits
Committee on Ways and Means
United States Congress
1102 Longworth House Office Building
Washington, DC 20515

Re: Tax Treatment of Health Insurance Benefits for Employees' Domestic Partners

Dear Congresswoman Black and Congressman Davis:

I write on behalf of the **Business Coalition for Benefits Tax Equity**, a group of leading U.S. employers that supports efforts to end the taxation of health insurance benefits for domestic partners – including unmarried opposite-sex and same-sex couples, as well as same-sex couples whose marriage or civil union is recognized at the state level – and to treat such benefits on par with those offered to federally recognized spouses and dependents. Davis & Harman LLP is counsel to the Coalition, whose members are listed in the Appendix to this submission.

I. Background: Current tax treatment of domestic partner benefits.

Under Code¹ Section 105(b), the value of health insurance premiums and benefits paid by an employer for coverage of an employee, “his spouse, his dependents,^[2] ... and any child” of the employee is excluded from the employee’s income for Federal income and payroll tax purposes. This value is also excluded in determining the employer’s payroll

¹ Unless otherwise specified, all Code and Section references herein are to the Internal Revenue Code of 1986, as amended.

² In general, under § 152(d), as modified by § 105(b), a non-spouse, non-relative is an employee’s “dependent” only if (1) that person has the same principal place of abode as the employee and is a member of the employee’s household (the “same household requirement”) and (2) the employee provides over 50% of that person’s support (the “50% support requirement”).

tax liability.³ But the same treatment does not apply to employer-provided domestic partner⁴ health insurance coverage:

- For health insurance provided to an employee’s state-recognized same-sex spouse, this disparity results from the Defense of Marriage Act,⁵ which provides that for all federal purposes, “the word ‘spouse’ refers only to a person of the opposite sex who is a husband or a wife.”⁶
- For an employee who is not married under state law to her domestic partner, the Section 105(b) exclusion is unavailable unless the domestic partner is the employee’s “dependent” for tax purposes.

Consequently, if an employer extends health insurance coverage to an employee’s non-dependent domestic partner, the employer is subject to payroll tax on the value of any domestic partner coverage the employee elects – even if, as discussed below, state law *requires* the employer to offer this coverage. Likewise, an employee that elects this coverage is subject to both income and payroll taxes on the value of the domestic partner coverage (including coverage paid with employee pre-tax contributions).

The imposition of these taxes is tantamount to a penalty *both* on the employer that voluntarily chooses or that is required under state law to offer domestic partner coverage *and* on the employee who elects the coverage. This penalty is fundamentally at odds with United States public policy, which to achieve the goal of full health insurance coverage, relies on employers to provide health insurance coverage to employees and their families.

The Coalition urges Congress to eliminate this penalty for employer-provided health insurance, as well as related penalties that apply to other tax-advantaged employee benefits. In particular, we support adoption of the approach, described below, taken by the Tax Parity for Health Plan Beneficiaries Act (the “Act”).

II. Scope of coverage.

As domestic partner coverage becomes increasingly available, this unequal tax treatment presents a growing challenge. Using 2010 data, the Bureau of Labor Statistics found that among civilian workers, “access to health care benefits for unmarried domestic partners

³ Parallel exclusions for such values are available from employment taxes (§ 3121(a)(2)); the railroad retirement tax (§ 3231(e)(1)); federal unemployment tax (§ 3306(b)(2)); and withholding requirements (§ 3401(a)).

⁴ For shorthand, the term “domestic partner” is generally used herein to refer also to same-sex couples whose marriage or civil union is recognized at the state level.

⁵ P.L. 104-199; 110 Stat. 2419.

⁶ 1 U.S.C. § 7 (2013).

is available to 30 percent of same sex partners and 25 percent of opposite sex partners.”⁷ More recently, a Mercer study found that 52 percent of all employers offer some form of domestic partner coverage.⁸ In absolute numbers, the number of opposite-sex domestic partners who receive this coverage is far higher than that of same-sex partners. Moreover, we note that domestic partner coverage does not always require an intimate relationship; for example, some employers choose to extend domestic partner coverage to an employee’s sibling if the employee and her sibling are financially interdependent and reside together.

Like thousands of other employers, Coalition members have chosen voluntarily to extend health insurance benefits to employees’ domestic partners for numerous reasons, among them: to attract and retain top talent; out of a sense of fairness to their employees who cannot or choose not to become married; and to comply with their own internal nondiscrimination policies.⁹

Additionally, some employers offer domestic partner benefits to comply with state law. In the health insurance context, the Employee Retirement Income Security Act of 1974 (ERISA) preempts state law only in the case of self-insured plans. Consequently, self-insured health plans – the overwhelming majority of which are offered by large employers¹⁰ – generally are shielded from state-law definitions of married spouse, civil union spouse, or domestic partner. But ERISA preemption is *not* applicable to fully insured health and welfare plans, and governmental or church employers normally fall outside the scope of ERISA entirely. Accordingly, private employers that purchase fully insured plans, and public and church employers, are generally subject to the insurance laws of states in which they operate. Such employers operating in the nine states (plus the District of Columbia) that solemnize same-sex marriages,¹¹ as well as in the six states that solemnize civil unions,¹² are generally required under state law to treat same-sex marriages and civil unions on par with opposite-sex marriages – and thus must offer same-sex married or civilly united spouses equivalent benefits as opposite-sex spouses. In

⁷ Bureau of Labor Statistics, *Employee Benefits in the United States (March 2011)*, *Unmarried Domestic Partners Benefit Fact Sheet*, July 26, 2011.

⁸ Julie Appleby, *Many Businesses Offer Health Benefits To Same-Sex Couples Ahead of Laws*, KAISER HEALTH NEWS, May 14, 2012 (reporting on a Mercer study).

⁹ See generally Hewitt Associates, *Benefit Programs for Domestic Partners & Same-Sex Spouses*, July 2005.

¹⁰ Paul Fronstin, *Self-Insured Health Plans: State Variation and Recent Trends by Firm Size*, EMPLOYEE BENEFIT RESEARCH INSTITUTE NOTES, Nov. 2012 (finding that in 2011, “68.5 percent of workers in firms with 50 or more employees were in self-insured plans, whereas only 10.8 percent of workers in firms with fewer than 50 employees were in self-insured plans).

¹¹ Currently, Connecticut, Iowa, Maine, Maryland, Massachusetts, New Hampshire, New York, Washington, and Vermont, as well as the District of Columbia, all authorize same-sex marriage.

¹² Currently, Colorado, Delaware, Hawaii, Illinois, New Jersey, and Rhode Island all authorize civil unions.

other words, small businesses are disproportionately required under state law to offer equivalent benefits to same-sex married spouses and civil union spouses. By extension, small businesses are more likely involuntarily to bear the associated payroll tax penalty.

III. Tax impact of unequal treatment.

The financial impact of this disparate treatment is hardly trivial. A 2007 UCLA Law School study found that domestic partners paid “on average \$1,069 per year more in taxes than would a married employee with the same coverage.”¹³ The same UCLA study found that employers in 2007 paid \$57 million in additional payroll taxes.

Based on more recent health costs and using common facts, we estimate that in 2012, a hypothetical employee earning a median wage who elects average family health coverage under her employer’s group health plan for both herself and her domestic partner will face more than a \$2,200 increase in federal tax liability as a consequence of the current tax disparity – raising her overall federal tax burden by more than 30%.

To help employees address this challenge, an increasing number of employers are choosing to provide a “gross up” in income to make whole those employees who have a higher tax burden on their domestic partner benefits.¹⁴ It is estimated that for an employee who incurs additional costs of \$1,200 to \$1,500, the employer would need to pay between \$2,000 and \$2,500 to gross-up the employee.¹⁵ When an employer is not able to be so generous as to provide a gross-up, many employees are likely to forego the coverage available to their domestic partners because they cannot afford the additional taxes. One analyst described the dilemma: “Taxed if you do, uninsured if you don’t.”

IV. Tax Parity for Health Plan Beneficiaries Act.

As your Committee undertakes tax reform, the Coalition urges incorporating the approach set forth in the Tax Parity for Health Plan Beneficiaries Act. The Act has been introduced in the House on a bipartisan, bicameral basis since the 108th Congress, most recently as H.R. 2088 in the 112th Congress.

¹³ M.V. Lee Badgett, *Unequal Taxes on Equal Benefits: The Taxation of Domestic Partner Benefits*, UCLA School of Law Williams Institute Working Paper, Dec. 2007.

¹⁴ See generally Human Rights Campaign, *Domestic Partner Benefits: Grossing Up to Offset Imputed Income Tax*, <http://www.hrc.org/resources/entry/domestic-partner-benefits-grossing-up-to-offset-imputed-income-tax>; Tara Siegel Bernard, *For Gay Employees, an Equalizer*, N.Y. TIMES, May 20, 2011, available at www.nytimes.com/2011/05/21/your-money/health-insurance/21money.htm; Tara Siegel Bernard, *A Progress Report on Gay Employee Health Benefits*, N.Y. TIMES BUCKS BLOG, Dec. 14, 2010 (updated Mar. 4, 2013), available at <http://bucks.blogs.nytimes.com/2010/12/14/a-progress-report-on-gay-employee-health-benefits> (listing employers that are currently grossing up employees to cover the tax penalty on health benefits extended to domestic partners).

¹⁵ Tara Siegel Bernard, *A Progress Report on Gay Employee Health Benefits*, N.Y. TIMES BUCKS BLOG, Dec. 14, 2010 (updated Mar. 4, 2013), available at <http://bucks.blogs.nytimes.com/2010/12/14/a-progress-report-on-gay-employee-health-benefits>.

Specifically, the Act would add a new paragraph (g) to Section 106, defining “eligible beneficiary” as “any individual who is eligible to receive benefits or coverage under an accident or health plan.”¹⁶ The value of coverage for an eligible beneficiary would qualify for the Section 105(b) exclusion (and the parallel exclusions outlined above). This definition would enable employers to retain current flexibility to establish their own criteria for demonstrating domestic partner status. And because it does not define or treat a domestic partner as a “spouse,” this definition would not implicate the federal Defense of Marriage Act.

The Coalition further urges Congress to adopt the Act’s other proposed provisions, all of which would further the public policy of expanding employee benefits to employees and their families. Specifically, the Act would:

- Expand “dependency” for purposes of self-employed taxpayers’ deduction of health insurance costs. Under Section 162(l), a self-employed taxpayer is permitted to claim an “above-the-line” deduction for insurance costs of the taxpayer and the taxpayer’s spouse and “dependents” – but not insurance costs of other persons. The bill would add a new subparagraph (E) to Section 162(l)(1), which would extend the ability to claim an above-the-line deduction for insurance costs for one individual age 19 or older who (i) has the same principal place of abode as the self-employed taxpayer; (ii) is a member of the self-employed taxpayer’s household; and (iii) is not otherwise related to the self-employed taxpayer.
- Make eligible beneficiaries eligible for sick and accident benefits provided to members of a Voluntary Employees’ Benefit Association and their dependents. A Voluntary Employees’ Benefit Association, or “VEBA,” is an entity that manages funds earmarked for the long-term health benefits of retirees. A VEBA may provide a wide range of benefits, including accident insurance, childcare costs, employee continuing education, legal services, life insurance benefits, severance pay, supplemental unemployment benefits, sick leave pay, training benefits, and vacation pay. VEBAs are exempt from Federal income taxation under Section 501(c)(9), provided they adhere to the VEBA rules under that section. Under current law, VEBAs can provide benefits only to members or “their dependents or designated beneficiaries.” The bill would expand the class of eligible individuals to include any eligible beneficiary, as defined under proposed Section 106(g), thus enabling a VEBA to provide benefits to non-spouse, non-dependent beneficiaries without endangering tax-exemption.

¹⁶ By referring to an “eligible beneficiary,” the bill avoids the potentially demeaning term “dependent” in what the parties typically view as a relationship of equals. It also avoids confusion with the established interpretation of dependency for tax purposes.

- Make eligible beneficiaries' qualifying expenses eligible for reimbursement under employees' Flexible Spending Arrangements and Health Reimbursement Arrangements. A Flexible Spending Arrangement (FSA) is a tax-advantaged financial account that enables an employee to set aside earnings to pay for qualifying expenses (typically medical or dependent care expenses) incurred by the employee, the employee's spouse, and any dependents. Under current Treasury Regulations, FSA funds cannot be used for qualifying expenses incurred by non-dependent domestic partners. A Health Reimbursement Arrangement (HRA) is an employer-funded medical reimbursement plan, by which the employer sets aside a specific amount of pre-tax dollars for employees, who use those funds to pay for qualifying health care expenses on an annual basis incurred by the employee, the employee's spouse, and any dependents. Under current Treasury Regulations, HRA funds cannot be used for qualifying expenses incurred by non-dependent domestic partners. The bill would direct the Treasury Secretary to promulgate regulations that make qualifying expenses incurred by an eligible beneficiary, as defined under proposed Section 106(g), eligible for reimbursement from an FSA or HRA.
- Make eligible beneficiaries' medical expenses eligible for reimbursement from Health Savings Accounts. A Health Savings Account (HSA) is a medical savings account that is available for taxpayers enrolled in a so-called High Deductible Health Plan. Under Section 223(d)(2)(A), HSA funds can be used to pay "qualified medical expenses," which include amounts for the employee, spouse, or dependent. The bill would amend the Code so that expenses for qualified beneficiaries, as defined under proposed Section 162(l)(1), can also be reimbursed.
- Enable eligible beneficiaries to qualify for retiree medical benefits. Under Section 401(h), a pension or annuity plan may provide for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses, and their dependents under certain arrangements. Associated contributions are tax-free in both the accumulation and retirement phases. Under current law, retiree benefits covering a non-dependent domestic partner are taxable to the employee during accumulation and retirement. The Act would add retiree medical benefits that cover an eligible beneficiary, as defined under new Section 106(g), of the employee or retiree to the list of benefits that are not taxable.

V. Conclusion.

Current law's unequal treatment of employer-provided health insurance coverage for domestic partners is a relic of a Tax Code written before the wide availability of these benefits. The impact of this unequal treatment is financially significant for both employers and employees. As you work to reform the Tax Code, the Coalition urges you to modify the Code so that employer-provided health benefits for domestic partners

(along with similar employee benefits) are treated on an equal basis as those offered to federally recognized spouses.

We would be pleased to answer any questions you might have. Should you have any questions for the Coalition or its members, your staff should feel free to contact me.

Thank you for your consideration.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Derek B. Dorn". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Derek B. Dorn
for the Business Coalition for Benefits Tax Equity

Appendix: Members of the Business Coalition for Benefits Tax Equity

Abt Associates, Cambridge, MA
Aetna, Hartford, CT
A.H. Wilder Foundation, St. Paul, MN
Alaska Air Group Inc., Seattle, WA
Alcoa Inc., Pittsburgh, PA
AMR Corp. (American Airlines), Fort Worth, TX
American Benefits Council, Washington, DC
Ameriprise Financial Inc., Minneapolis, MN
AT&T Inc., Dallas, TX
Bank of America Corp., Charlotte, NC
Bausch & Lomb Inc., Rochester, NY
Best Buy Co. Inc., Richfield, MN
Bingham McCutchen LLP, Boston, MA
BlueCross BlueShield of MN, Eagan, MN
Boehringer Ingelheim USA Corp, Ridgefield, CT
Capital One Financial Corp., Falls Church, VA
Cardinal Health Inc., Dublin, OH
Carlson Companies, Minneapolis, MN
Charles Schwab & Co Inc., San Francisco, CA
The Chubb Corp., Warren, NJ
Citigroup Inc., New York, NY
CNA Insurance, Chicago, IL
College & University Professional Association for Human Resources, Knoxville, TN
Corning Inc., Corning, NY
Cullen Weston Pines & Bach LLP, Madison, WI
Day One, South Portland, ME
Deloitte LLP, New York, NY
Delta Air Lines Inc., Atlanta, GA
The Depository Trust & Clearing Corp., New York, NY
Diageo North America, Norwalk, CT
The Dow Chemical Co., Midland, MI
Eastman Kodak Co., Rochester, NY
The ERISA Industry Committee, Washington, DC
Ernst & Young, New York, NY
Exelon Corp., Chicago, IL
General Mills Inc., Minneapolis, MN
General Motors, Detroit, MI
GlaxoSmithKline, Research Triangle Park, NC
Goldman, Sachs & Co., New York, NY
Google Inc., Mountain View, CA
Herman Miller Inc., Zeeland, MI
Hewlett-Packard Co., Palo Alto, CA
HSBC North America, New York, NY
IBM Corp., Armonk, NY

ICMA Retirement Corp., Washington, DC
Intel Corp., Santa Clara, CA
J.P. Morgan Chase & Co., New York, NY
JetBlue Airways Corp., Forest Hills, NY
KPMG LLP, New York, NY
Levi Strauss & Co., San Francisco, CA
The Hartford, Hartford, CT
Marriott International Inc., Bethesda, MD
Marsh & McLennan Companies Inc., New York, NY
MassMutual Financial Group, Springfield, MA
Medtronic Inc., Minneapolis, MN
Merck & Co. Inc., New York, NY
MetLife Inc., New York, NY
Microsoft Corp., Redmond, WA
MillerCoors Brewing Co., Chicago, IL
Moody's Corp., New York, NY
Morgan Stanley, New York, NY
Motorola, Schaumburg, IL
Nationwide, Columbus, OH
Nike Inc., Beaverton, OR
Ocera Therapeutics, San Diego, CA
PG&E Corp., San Francisco, CA
PricewaterhouseCoopers, New York, NY
Project for Pride in Living, Minneapolis, MN
Prudential Financial, Newark, NJ
Quorum Review Inc., Seattle, WA
Replacements Ltd., Greensboro, NC
Russell Investment Group, Tacoma, WA
Sempra Energy, San Diego, CA
Society for Human Resource Management (SHRM), Alexandria, VA
State Street Corp., Boston, MA
Texas Instruments, Dallas, TX
Thomson Reuters, New York, NY
TIAA-CREF, New York, NY
Time Warner Inc., New York, NY
UBS AG, Stamford, CT
Verizon Communications Inc., New York, NY
WellPoint, Indianapolis, IN
Winston & Strawn LLP, Chicago, IL
World at Work, Washington, DC
Xerox Corp., Norwalk, CT
Yale University, New Haven, CT