Imputed Income and Domestic Partner Benefits

Figure 1 (Shutterstock)

If you're an employer who offers "Domestic Partner" benefits, congratulations – you're one of many progressive companies trying to make a difference in today's workforce. If you've been thinking about offering domestic partner benefits, there are a few things to consider and have in place prior to communicating the benefits to your employees.

Before making the decision to offer domestic partner benefits, employers are encouraged to have the following items in place:

- Domestic Partner Policy;
- Domestic Partner Affidavit;
- Domestic Partner Affidavit of termination; and most importantly
- Education on imputed income and what it really means to the employee

Let's start with the definition of what a domestic partnership is. As defined by Wikipedia, a domestic partnership is "an interpersonal relationship between two individuals who live together and share a common domestic life, but are not married (to each other or to anyone else)." Seems fairly straight forward, but in terms of offering benefits it's much more complicated than it appears.

As domestic partners are not considered tax dependents or a legal spouse for federal tax purposes, the rules applying to their benefit elections are very different. Unless a domestic partner meets the criteria of **the Internal Revenue Code §152(d),** an employer must treat the Fair Market Value (FMV) of the healthcare coverage extended to the domestic partner as taxable income to the employee. The value of this benefit *must* be included as imputed income on the employee's state and federal W-2 forms. Here's an example of what this might look like for an employee adding a domestic partner to their medical insurance:

Plan Election	FMV of plan (annual)
Employee only plan	$7,000
Employee + 1 plan	$12,000
Plan Value Difference	$5,000

The plan value difference less any post tax deductions for the domestic partner coverage is considered the imputed income or non-cash taxable compensation, and must be added to the employee's W-2s. The employee's contributions on the other hand are considered pre-tax under section 125. The imputed income must be taxed for *employee and employer* taxes. These amounts may also affect other necessary calculations such as 401K contributions and ACA affordability.

The same imputed income calculation must also be applied to the other benefits the company extends to the domestic partner. This includes: dental, vision and usage of an HRA *if the company allows for domestic partner usage of the account*. Once the "final" imputed income figure has been determined, company administrators will need to determine how it is reported to the employee – per paycheck or at the end of the year. Best practice has been to report the imputed income on a per paycheck basis so employees are not surprised at the end of the year but this is at the company's discretion.

As the imputed income may affect individual tax brackets and potentially any additional assistance employees may be receiving from the state, it is always recommended for employees to speak with their tax advisors before adding their domestic partner to their benefits.

Making the decision to offer domestic partner benefits is not always easy, given the administrative work involved, in addition to the tax ramifications for both the employee and the employer. However, if one chooses to offer the benefits to their employees, proper administration and tax treatment of benefits remains just as important as ever.