



SCHOOL & COLLEGE LEGAL SERVICES OF CALIFORNIA

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5350 Skylane Boulevard
Santa Rosa, CA 95403

Tel: (707) 524-2690
Fax: (707) 578-0517
santarosa@sclscal.org
www.sclscal.org

General Counsel
Carl D. Corbin

Attorneys
Ellie R. Austin
Monica D. Batanero
Jennifer Henry
Sarah Hirschfeld-Sussman
Nancy L. Klein
Damara L. Moore
Jennifer E. Nix
Steven P. Reiner
Kaitlyn A. Schwendeman
Loren W. Soukup
Erin E. Stagg

Of Counsel
Robert J. Henry
Margaret M. Merchat
Patrick C. Wilson
Frank Zotter, Jr.

LEGAL UPDATE

October 11, 2019

To: Superintendents/Presidents/Chancellors, Member
Community College Districts

From: Kaitlyn Schwendeman, Schools Legal Counsel KAS

Subject: Updated Taxation of Domestic Partner Benefits
Memo No. 14-2019(CC)

Our office is reissuing this Legal Update on the taxation of domestic partner benefits, last issued in 2010 as Legal Update 16-2010(CC), in response to inquiries for updated guidance in this area. If your college has any questions regarding the taxation of these employees, please do not hesitate to reach out to our office.

Federal Law

Federal law does not recognize domestic partners as having the same standing as a spouse or qualified dependent when it comes to the taxation of an employee’s benefits. As such, federal law requires that the employer compute the fair market value of domestic partner benefits and include this in the gross income of the employee as compensation, if the employee elects for their eligible domestic partner to receive benefits through an employer-sponsored plan. This income must be reported in the employee’s W-2 and is subject to withholding for income, Social Security and Medicare taxes. In addition, the income is also considered wages for Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA).

Exception: In limited circumstances, a domestic partner may qualify as a “dependent” under Internal Revenue Code (“IRC”) section 105(b). If so, they would be treated as any other qualified dependent and their benefits would not be included in the employee’s gross income. In order for a domestic partner to qualify as a “dependent” under section 105(b), the domestic partner must meet all of the following:

1. Live with the employee for the full taxable year, except for temporary absences such as vacation, military service or education.
2. Is a citizen or legal resident of the United States.
3. Is not a qualifying dependent for anyone else under section 152 of the IRC.
4. Receive more than one half of their support from the employee.¹

¹ IRC section 152.



If your plan offers coverage to the child of an employee's domestic partner, the same dependent analysis would apply. If the domestic partner's child cannot meet all the above criterion, then the fair market value of the benefits for the child must be computed and included as income for the employee.

Note: Practically speaking, it is unlikely that a domestic partner's child would qualify under the dependent test, as the child would most likely be considered the dependent of the domestic partner (and thus would fail criteria #3). Therefore, it is likely any benefits extended on behalf of the child would be taxable as wages to the employee.

California Law

California law requires that employers provide the same benefits to employees with registered domestic partners as would be provided to spouses of employees.²

California Family Code section 297 defines domestic partners as two adults who have chosen to share one another's lives in an intimate and committed relationship of mutual caring. A registered domestic partnership is created when both persons have filed a Declaration of Domestic Partnership with the Secretary of State, and at the time of filing, all of the following requirements are met:

1. Neither person is married to someone else or is a member of another domestic partnership with someone else that has not been terminated, dissolved, or adjudged a nullity.
2. The two persons are not related by blood in a way that would prevent them from being married to each other in this State.
3. Both persons are at least 18 years of age.³
4. Both persons are capable of consenting to the domestic partnership.

Note: As of July 30, 2019, the requirements to form a domestic partnership have been amended. Previously, domestic partnerships in California could only be formed between same sex partners or opposite sex partners where one or both persons were over 62 years of age. These requirements have been repealed.

Employers are not required to verify an employee's claim of a registered domestic partnership. The Fair Employment and Housing Act protects employees from discrimination on the basis of marital status; if employers do not currently have a policy of seeking documentation of marital status from employees, they should not request documentation of domestic partnership status. Similarly, the California Insurance Equity Act provides that insurance carriers can only require documentation of domestic partnership if they also require proof of marriage.

California Revenue and Tax Code section 17021.7 requires that a registered domestic partner of a taxpayer be treated as a spouse or former spouse of that taxpayer for most purposes. This code section extends tax benefits to registered domestic partners and their partner's dependent's health coverage, and excludes coverage amounts from the employee's gross income.

² Employers are not required by law to provide the same benefits to unregistered domestic partners, though some colleges extend such benefits by policy or regulation.

³ There is an exception within the law for domestic partners under the age of 18, if both partners obtain the consent of their parents and a court order granting permission, as well as meet other requirements, set forth in the law. Family Code section 297.1.



Conclusion

In light of the above, qualified domestic partner benefit coverage amounts shall be excluded from California taxation if the employee meets the domestic partnership test and is registered with the State. In that case, the fair market value of the domestic partner's benefits shall only be classified as income for federal tax purposes (except in the rare circumstance where the domestic partner qualifies as a dependent under IRC section 104(b)). However, if the employee does not meet California eligibility, the benefits shall be considered income for both state and federal tax purposes.

Fair Market Value of Benefits

If it is determined that the domestic partner's benefits must be classified as taxable income to the employee, the employer must determine the fair market value of the benefits. The IRS does not provide any official guidance on how to determine the fair market value, however, there are two generally accepted methods:

- **Tiered Rates**: The difference between the amount the employer would contribute for the employee alone and the amount the employer would contribute for coverage of an employee and a spouse and/or dependents (as applicable).
- **Composite Rates**: If the employer pays a composite rate for employees, it must use the computed fair market value percentage formulas as determined by the coverage carrier. The employer will have to contact its carrier for this information.

Examples of Tiered Rate:

- **Employee + 1**: An employee has no children, but does have a registered domestic partner. The medical plan they are enrolled in has an Employee + 1 rate of \$450.00/mo. The Employee Only rate is \$300.00/mo. The difference is \$150.00/mo. Thus, the increase in taxable income to the employee would be \$150.00 per month plus any applicable Social Security and Medicare taxes.
- **Employee + 2 (One Dependent of Domestic Partner)**: An employee has a domestic partner and the domestic partner has one child (who is not a dependent of the employee). The medical plan they are enrolled in has an Employee + 2 rate of \$550.00/mo. The Employee rate is \$300.00. The difference is \$250.00/mo. Since the employer must tax the fair market value of both the domestic partner and the child's benefits, the increase in taxable income to the employee would be \$250.00 per month plus any applicable Social Security and Medicare taxes.

Please contact our office with questions regarding this Legal Update or any other matter.

The information in this Legal Update is provided as a summary of law and is not intended as legal advice. Application of the law may vary depending on the particular facts and circumstances at issue. We, therefore, recommend that you consult legal counsel to advise you on how the law applies to your specific situation.

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