

INTERNAL REVENUE SERVICE  
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Assistant District Counsel, New England

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Assistant Chief Counsel CC:EBEO

Internal Revenue Service National Office Field Service Advice

This Field Service Advice responds to your memorandum dated September 9, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

You have submitted a memorandum concerning the federal income tax consequences of the extension of an employer's group health benefits plan to persons other than its employees, their spouses and dependents.

We generally concur in your discussion of the tax treatment of health benefits provided to domestic partners with the following recommended changes:

The second sentence of footnote 2 on page 2 should be rewritten to state: "Employer-financed benefits will, however, be excluded for amounts received for medical care of the taxpayer or his spouse or dependent. I.R.C. section 105(b)."

We also recommend that in the Conclusion section, the following two sentences be deleted: "The broad definition of the term dependent under Massachusetts law lends support to the argument that a domestic partner may qualify as a dependent for purposes of excluding health insurance benefits from an employee's gross income" and "Although the term is not defined specifically for tax purposes, there is nothing in local case law that narrowly defines the term dependent."

Local law does not define the term "dependent" for federal tax purposes. That term is defined in section 152(a) of the Code. Local law is considered solely for the purpose of determining whether "the relationship between such individual and the taxpayer is in violation of local law." Section 152(b)(5). If the relationship is in violation of local law, the individual cannot be a member of the taxpayer's household.

If the domestic partner does not qualify as a spouse or dependent of the taxpayer and the health benefits are includible in the employee's gross income, you ask how those benefits are to be valued. The excess of the fair market value of the group medical coverage provided by the employer over the amount paid by the employee for such coverage is includible in the gross income of the employee under section 61. Fair market value is determined on the basis of all the facts and circumstances. Section 1.61-21(b)(2). The Service does not rule on factual issues and therefore does not issue rulings to the taxpayer on fair market value. Section 4.02(1) of Rev. Proc. 98-1.

Finally, you ask whether the value of the benefits which are includible in the employee's gross income is subject to employment taxes. The amount includible in the gross income of the employee by reason of the coverage of a domestic partner constitutes "wages" under section 3401(a) and is subject to income tax withholding under section 3402, constitutes "wages" within the meaning of section 3121(a) and is subject to FICA taxes, and constitutes "wages" within the meaning of section 3306(b) and is subject to FUTA taxes.

If you have any questions, please call (202)622-6080.

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By: Harry Beker

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