



# Health Coverage for Dependents: Federal Tax Rules

Many health plans provide coverage for employees' dependent children. The Affordable Care Act (ACA) requires health plans that cover dependent children to provide this coverage up to age 26. Also, applicable large employers (ALEs) may be subject to penalties under the ACA if they do not offer affordable, minimum-value health coverage to full-time employees and their dependent children.

Whether dependent coverage under a health plan is tax-free at the federal level depends on whether the individuals qualify as dependents under the Internal Revenue Code (Code). An individual can qualify as a dependent under the Code by being any one of the following:

- A child of the employee who has not attained age 27 as of the end of the taxable year;
- A qualifying child, as defined in Code Section 152; or
- A qualifying relative, as defined in Code Section 152.

Other types of dependents may be covered under a group health plan, but their coverage may be taxable.

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## LINKS AND RESOURCES

- [Final regulations](#) regarding the ACA's mandate for dependent coverage up to age 26
- [Final regulations](#) that include a definition of "child" for purposes of the ACA's age 26 mandate

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## Dependent Coverage Rules Under the ACA

The ACA requires health plans and health insurance issuers that offer dependent coverage to children on their parents' plans to make the coverage available until the child reaches age 26.

A child's eligibility for dependent coverage under this rule is based solely on the child's age and his or her relationship to the participant. If the child is under age 26 and is the participant's child, he or she is eligible for dependent coverage. This means that a plan or issuer may not deny or restrict coverage for a child who is under age 26 based on whether the child is financially dependent on the participant, resides with the participant or with any other person, is a student, is unmarried, is employed or any combination of these factors.

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### Who Is a "Child" under the Age 26 Mandate?

[Final regulations](#) under the ACA define a "child" to include biological and legally adopted children (including children placed for adoption), stepchildren and eligible foster children. An eligible foster child means a child placed with the employee by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction. Children who do not fall under one these categories (such as grandchildren) are not required to be covered to age 26, even if they are eligible for health plan coverage. Also, plans can impose other eligibility criteria on children who do not fall under the ACA's age 26 coverage mandate, such as a condition that the individual be a dependent for income tax purposes.

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Failing to comply with this coverage mandate may trigger an excise tax of up to **\$100 per day** with respect to each individual to whom the failure relates.

## Tax Rules

The ACA also revised the Code to provide that the extended dependent coverage is tax-free to the employee. However, the tax rules differ slightly from the coverage requirement. Under the Code, tax-free coverage is available to “any child (son, daughter, stepson, stepdaughter, adopted child or eligible foster child of the taxpayer) who as of the end of the taxable year has not attained age 27.” If the child has coverage beyond age 26, that coverage will be tax-free until the end of the tax year.

Because of the broad tax exclusion provided by the ACA, this definition may be the only one a plan may need to review to determine if the coverage is tax-free for the employee’s child. However, there are circumstances where the Code Section 152 definition of dependent may still be necessary. For example, if the dependent is over age 26 and is disabled or is a grandchild, niece or nephew rather than the employee’s child, health plan coverage may be provided on a tax-free basis if the Code Section 152 definition is met.

## Relationship with the Employer Shared Responsibility Rules

The ACA’s age 26 coverage mandate does not require plans and issuers to offer dependent coverage at all. Instead, the mandate requires plans and issuers that provide coverage to dependent children to make that coverage available until the child reaches age 26. However, the ACA’s employer shared responsibility rules began imposing penalties on ALEs—those with 50 or more full-time and full-time equivalent employees—that do not offer coverage to all full-time employees and their dependent children.

For purposes of the employer shared responsibility rules, a “dependent” is defined as a biological or adopted son or daughter who is under 26 years of age. The employer shared responsibility [final regulations](#) clarify that a child is a dependent for purposes of the employer shared responsibility penalties for the entire calendar month in which he or she attains age 26. However, the final rules exclude stepchildren and foster children from the definition of dependent.

As a result, ALEs that are subject to the employer shared responsibility rules must offer dependent coverage to children of their full-time employees through the entire month in which the dependent attains age 26 in order to avoid the employer shared responsibility penalties. This means that:

- Employers are not subject to penalties under the adult coverage mandate if they do not offer dependent coverage at all, or terminate dependent coverage on the child’s 26th birthday; but
- ALEs that are subject to the ACA’s employer shared responsibility rules may be subject to penalties if they do not offer dependent coverage to the children of their full-time employees through the entire month in which the dependent attains age 26.

**Employers who are subject to both of these ACA mandates should be sure to comply with both requirements.**

## Code Section 152 Definition of Dependent

Under the Code Section 152 definition of dependent, an individual must be either a “qualifying child” or a “qualifying relative,” as described in the definitions below. However, as outlined in the next section, there are exceptions to these definitions when it comes to eligibility for tax-free, employer-provided health care. Note that these requirements are more restrictive than the broad definition of dependent added by the ACA.

### Qualifying Child

A qualifying child must meet all of the following requirements:

- Is the employee’s daughter, son, stepchild, adopted child, eligible foster child, sibling, half-sibling, stepsibling or a descendant of any of these individuals;
- Has the same principal abode as the employee for over half the year;
- Is younger than the employee, is under age 19 at the end of the year (or, if a full-time student, under age 24 at the end of the year) or disabled;
- Does not provide more than half of his or her own support; and
- Is unmarried (but see exception below).

An individual may be treated as the qualifying child of a non-parent if no parent claims the individual as a qualifying child and the non-parent has a higher adjusted gross income than any parent.

### Qualifying Relative

A qualifying relative must meet all of the following requirements:

- Is not a qualifying child;

- Is a relative of the employee or has the same principal place of abode as the employee and is a member of the employee's household;
- Has gross income under the personal exemption amount for purposes of computing taxable income (see exception below); and
- Receives more than half of his or her support from the employee.

## Impact on Employer-Provided Health Coverage

Under the ACA's definition of dependent employers have to confirm only that the individual is the participant's child who is under age 27 as of the end of the tax year. However, an individual can still qualify as a dependent, and be eligible for tax-free coverage, under Code Section 152.

When using the Code Section 152 dependent definitions, keep in mind that, for purposes of determining whether an individual is a dependent eligible for tax-free health benefits, certain portions of the Code Section 152 definition will not apply. Requirements related to married dependents and dependents with children, along with the gross income limitation in the definition of qualifying relative, are not applicable. Specifically, to be a qualifying child, the child can be married, but cannot file a joint return with his or her spouse, unless it is to claim a refund. A qualifying relative can be married and is able to file a joint return with a spouse.

Due to these technical corrections, certain individuals who would otherwise not qualify as dependents under Code Section 152 may still qualify for tax-free health benefits. For example, an employee's child who does not meet the definition of qualifying child may still be a qualifying relative for health coverage purposes, even if he or she earns more than the gross income limit set out in that definition.

## Coverage for Non-Tax Dependents

Some employers may wish, or be required, to cover individuals not considered dependents under either the Code Section 152 definition or the ACA's definition. For example, some states require employers to provide coverage for dependent children up to a certain age beyond age 26 or for employees' domestic partners. Coverage for an individual who is not a dependent under the tax code will not qualify for exclusion from the employee's income and cannot be paid for on a pre-tax basis under a cafeteria plan, even if the dependent is eligible for coverage under the terms of the health plan. Therefore, employers should be aware of potential tax consequences of covering these individuals and should communicate those consequences to employees.

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