

Compliance Corner: IRS Releases Clarification Regarding “Tie-breaking” Rule for Two or More Taxpayers Claiming a Child as a Qualifying Child

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The IRS recently published Notice 2006-86 which clarifies the applicability of “tie-breaking rule” for determining which taxpayer may claim a qualifying child when two or more taxpayers claim the same child for a taxable year. The Notice applies to the head of household filing status under § 2(b), the child and dependent care credit under § 21, the child tax credit under § 24, the earned income credit under § 32, the exclusion for dependent care assistance under § 129, and the dependency deduction under § 151.

The tie-breaking rule provides the following:

- If one or none of the taxpayers claiming the child is the child’s parent, the child is treated as the qualifying child of (i) the taxpayer who is the child’s parent, or (ii) if none of the taxpayers is the child’s parent, the taxpayer with the highest adjusted gross income for that taxable year.

Hewitt Study Finds Employees Struggling to Effectively Manage Their Healthcare

Business Wire

Despite concerns over rising healthcare costs and the increasing complexity of health plans, a new study from Hewitt Associates, a global human resources services firm, found that most employees aren't effectively managing their healthcare and are looking to employers to provide resources that can help them make better and more informed decisions throughout the year.

According to Hewitt’s study of more than 18,000 U.S. employees, almost 80 percent worry healthcare coverage will ultimately become unaffordable, and more than half believe that choosing and using the healthcare plan that best meets their needs gets more complex every year. Yet just 34 percent track their current healthcare expenses, and less than half take the time to estimate future healthcare expenses. Further, while the majority of employees believe their companies provide sufficient tools and information to choose and use their health plans, only half say they used those tools.

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- If both taxpayers of the qualifying child are the child’s parents who do not file a joint return, the child is treated as the qualifying child of the parent with whom the child resides for the longer period of time during the taxable year. If the child resides with both parents for the same amount of time during the taxable year, the child is treated as the qualifying child of the parent with the higher adjusted gross income for that taxable year.

Special Rule for Non-Custodial Parents:

A child may be treated as the qualifying child of the non-custodial parent, for certain purposes, if:

- the child is in the custody of one or both parents for more than one-half of the calendar year;
- the child receives over one-half of the child’s support during the calendar year from the child’s parents;
- the parents--(a) are divorced or separated under a decree of divorce or separate maintenance, (b) are separated under a written separation agreement, or, c) live apart at all times during the last 6 months of the calendar year; and
- the custodial parent releases the claim to the exemption to the non-custodial parent in a written declaration that the non-custodial parent attaches to the non-custodial parent’s tax return.

If the special rule outlined above does **not** apply, the tie-breaking rule applies to the provisions listed above *as a group*, rather than on a section-by-section basis. Therefore, if a child is treated as the qualifying child of one taxpayer for one purpose (e.g. earned income credit), the child may not be treated as the qualifying child of any other taxpayer for any other purpose (e.g. child tax credit, the child and dependent care credit, and/or exclusion under a dependent care FSA). If, however, the special rule applies, a child may be treated as the qualifying child of two taxpayers. As such, the non-custodial parent may claim the child as a qualifying child under for purposes of the child tax credit under § 24 and the dependency deduction under § 151. ***However, for purposes of determining the head of household filing status, the earned income credit, the dependent care credit or the exclusion from income for dependent care FSAs, the non-custodial parent may not claim the child as a qualifying child. For these purposes, only the custodial parent (or other eligible taxpayer) may claim the child as a qualifying child. “Custodial parent” is defined as the parent having custody of the child for the greater portion of the calendar year, and “non-custodial parent” as the parent who is not the custodial parent. Note for purposes of dependent care FSAs, the child is always treated as the qualifying child of the custodial parent.*** 🔥

There are several examples included in the Notice. A copy of IRS Notice 2006-86 is available using the following link:

<http://www.irs.gov/pub/irs-drop/n-06-86.pdf>

Hewitt Study Finds Employees Struggling to Effectively Manage Their Healthcare

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"Employees are increasingly being tasked with making tougher and more important choices about their healthcare, but most are struggling to make the best choices at enrollment and throughout the year," said Jennifer Murphy, healthcare communication leader, Hewitt Associates. "While companies are providing additional education and resources to employees to help them make better choices, too much healthcare communication is still focused on enrollment, with little promotion or education throughout the year when people are really using their plans. As health plans become more complex, it's critical that employers have a year-round strategy that includes ways to promote the tools and educate employees and their families. Bottom line, companies need to be the ones who support and influence consumers' healthcare behaviors."

Navigating Complex Health Plans

According to Hewitt's study, the increasing level of complexity involved in choosing and using healthcare plans continues to be an issue for employees, particularly for those enrolled in high-deductible health plans (HDHPs) with health savings accounts (HSAs).

Hewitt's study found employees' overall understanding of and satisfaction with these plans is low among those who are participating in them. Only 30 percent of employees using

HDHPs with HSAs said they understood and were satisfied with their selection, and more than half said they wouldn't re-enroll next year. Although HSAs feature longer-term savings benefits, few people who enrolled said they were taking advantage of that aspect of the plans. Approximately 40 percent chose them because of the lower premium costs versus other plans, and more than two-thirds used the plans to deal with routine health expenses.

"As healthcare costs continue to rise, HSAs are great vehicles for helping employees save for future healthcare expenses, but they can be ineffective or confusing to employees if they aren't using them in the right way," said Murphy. "Positive testimonials from employees who have enrolled in an HDHP coupled with an HSA show that a greater emphasis on tools can help employees understand how to use their health plans and can boost satisfaction while improving next year's enrollment results. It's also critical that the education flow continues after enrollment so employees can avoid making mistakes."

Influencing Healthy Behaviors

According to Hewitt's study, tools such as health risk questionnaires (HRQs) can make a difference in influencing healthy behaviors by

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helping employees more easily understand and address their healthcare needs. Of the employees who completed a health risk questionnaire, three-quarters said they found the results valuable. More than 40 percent said they learned something new about their health, and more than half said they took actions to reduce or manage potential health risks.

However, only 32 percent of those who completed an HRQ said they were required to participate in any follow-up actions or activities, and less than a quarter said their spouses or partners were invited to complete one, making it difficult to assess family health needs.

"A great first step in providing an environment that supports and enables healthy behaviors is offering a health risk questionnaire, a resource designed to heighten employees' awareness of their health risks," added Murphy. "New or increased awareness is helpful, but behavioral changes might not take root to form new habits if companies don't provide any follow-up for employees. Companies can help employees maintain the momentum that an HRQ might provide by adding programs that encourage employees to take action after the initial questionnaire is completed."

Hewitt's study also found the percentage of employees who said they practiced healthy behaviors, such as regular exercise, balanced

diet, regularly scheduled physicals and preventive medicines, has remained constant over the past three years. In addition, the frequency of behaviors related to doctor's visits, including researching illness symptoms, asking doctors questions and discussing treatment options, has stayed relatively constant.

"To see sustained improvement in healthy behaviors, companies need to provide incentives that reward the desired behaviors through their plan designs, and then reinforce the right messages in communication throughout the year--not just at enrollment," said Murphy. 🌟

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Health Savings Accounts Give Employers Insurance Options

Salt Lake Tribune, The

Last year, Joe Knight found himself in a quandary common to small businessmen: With two employees' families struck with prolonged, costly illnesses, his Ogden firm was facing monstrous spikes in the cost of healthcare.

Knight, co-owner of Ogden-based Setpoint Cos., turned to an option that is becoming increasingly popular -- ditching the traditional health insurance system in favor of a savings account, paid in part by the employer and, depending on the plan, in part by the worker.

"I was surprised to find that the [health savings account] option was far better financially for all of my people, even my employees with medical situations," he told a Senate committee Tuesday. "Now that we are nearly through our second year with an HSA, everyone is happy with the change."

The accounts are tax-free and tied to health plans with high deductibles. Policyholders pay up front for doctor visits, prescriptions and trips to the dentist from the accounts. Unlike flexible-spending accounts, any unused money rolls over from year to year.

High deductibles -- they start at \$1,050 per person and \$2,100 per family -- keep the policies cheap and, as a result, employers can afford to pay more of an employee's premium or finance a portion of the accounts. Annual out-of-pocket expenses are

capped at \$5,250 for an individual or \$10,500 for a family.

Sen. Orrin Hatch, who chaired the hearing of the Senate Finance Subcommittee on Health Care, is sponsoring legislation aimed at offering incentives and expanding the savings accounts.

The Utah Republican argues that giving workers a savings account to pay health costs makes them more active participants in choosing their medical care, encouraging them to seek out better deals and save their money, something they can't do with traditional employer-provided coverage.

"The economics of it works. The practicality of it works, too," Hatch said. The cost of medical care will come down "if we can get people to be concerned about the cost of their treatment."

The savings accounts are also a key component of the Bush administration's health plan. Deputy Assistant Treasury Secretary Robert Carroll said consumers will make the most responsible choices when they have "more skin in the game."

The number of people enrolled in HSAs has grown, from fewer than a million in March 2005 to nearly 3.2 million in January 2006, according to

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America's Health Insurance Plans, a national health-insurance trade association.

But Sen. Jay Rockefeller, D-W.Va., is not convinced that the savings accounts are the panacea that Hatch and others claim, and could actually harm lower-income or chronically ill individuals.

The accounts will primarily benefit those in higher income brackets and healthier workers, he says. Only about 4 percent of employer-sponsored health plans fell into that category, according to the annual report by the nonprofit Kaiser Family Foundation and the Health Research and Educational Trust that was released Tuesday.

"As healthier and more affluent workers shift to HSAs, older and sicker workers will be left in traditional employer-sponsored policies," Rockefeller said. "This type of adverse selection will drive up premiums for traditional employer-based coverage, further encouraging firms to provide less desirable coverage or to drop health coverage altogether."

The savings accounts generally carry much lower premiums, but much higher deductibles. Research by the Government Accountability Office, Congress' nonpartisan investigative service, found that the average deductible was nearly six times higher in the HSAs than in typical plans.

The GAO also found that more than half of those who had signed up for the accounts made more

than \$75,000 a year as of 2004. The average income was \$133,000.

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Workers Facing New Benefit Options in Open Enrollment Season

PR Newswire

U.S. workers can expect to see more financial incentives, new benefit choices and greater scrutiny of dependent coverage in the upcoming open enrollment season, according to benefits consultants at Watson Wyatt Worldwide, a leading global consulting firm.

"As employees pick up more responsibility for funding healthcare and other benefits, open enrollment is the perfect time for workers to evaluate their benefits and ensure that they select the coverage that is right for them and their families," said Tom Billet, a senior consultant with Watson Wyatt. "Generally, workers will see higher premiums, deductibles and co-payments for medical and prescription drug benefits, making it even more critical for workers to review what benefits they had this year when evaluating their options for 2007."

Here are some of the major trends that benefits experts at Watson Wyatt, which consults with large employers on their open enrollment programs, have identified for this year's season:

- High-deductible/personal healthcare accounts growing. Employer interest in consumer-driven health plans (CDHPs) continues to grow as more companies add high-deductible health plans as well as personal account plans, especially health savings accounts (HSAs). A Watson Wyatt/National Business Group on Health survey found that 29 percent of employers now offer a high-deductible health plan with a personal account, and another 33 percent plan to add one for 2007. Also, a few large employers will exclusively offer a CDHP, eliminating all other plan options.
- Growing use of debit/electronic payment cards. Debit cards, now called electronic payment cards, can be used not only at doctors' offices but to pay for prescriptions and other healthcare-related expenses. Cards linked to healthcare accounts are gaining in popularity as employers integrate health accounts and more employees rely on account balances to help fund their claim expenses. With employees paying more at the point of care, affordability has become a growing concern for lower-paid employees. To accommodate these workers, some employers are introducing electronic payment cards with a line of credit.
- More health risk assessments, greater financial incentives. As employers continue to look for ways to control rising healthcare costs, an increasing number


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are offering employees incentives to complete a health risk assessment. The Watson Wyatt/National Business Group on Health report shows that two-thirds of employers offered employees a health risk appraisal this year, and another 21 percent plan to offer them in 2007. In return for completing the self-assessment, employers usually offer workers incentives such as financial rewards. The health risk assessment helps companies identify workers for participation in various disease management programs.

- Greater scrutiny of dependent coverage. Many employers are paying closer attention to employees who sign up their spouses and children for health benefit coverage. Watson Wyatt estimates that, typically, between 6 percent and 8 percent of dependents enrolled in a plan are not truly eligible for coverage, but some employers have seen much higher percentages when conducting audits. As a result, more employers are asking workers to demonstrate proof of dependency and are auditing their plans to verify that dependents are eligible. Some employers are also charging additional premiums to cover a spouse if he or she can be covered by his or her own employer's health plan.
- More automatic 401(k) plans. More employers are automatically enrolling eligible workers in 401(k) retirement plans, a trend that is encouraged by the new Pension Protection Act. Employees enrolled in an automatic plan are notified at least annually of the percentage of their pay that will be contributed to the plan and how it will be invested. Employees can accept the employer's election, make their own investment decisions or elect not to contribute anything to the 401(k) plan. If employees do not make any decision, however, contributions will be withheld from their pay and contributed to the 401(k) plan as outlined in their notice.

"Open enrollment is also the time when employees who participate in flexible spending accounts (FSAs) should review their account balance," said Randall Abbott, a senior consultant with Watson Wyatt. "Although the law allows companies to extend the deadline for workers to deplete their accounts by permitting coverage of expenses for a limited time in the new year, not every company has adopted the new option. Many workers will still have until December 31 to use or lose their FSA funds. It pays for employees to double-check what their employer allows." 

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