

May 12, 2010

New Rules on Extension of Health Plan Coverage to Children Up to Age 26

An [interim final rule](#) implementing the mandatory extension of health plan coverage to children up to age 26, as passed under the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (together, the Affordable Care Act), has been released. The regulations were issued by the so-called tri-agency task force¹ that is developing many of the rules for provisions of the Affordable Care Act that affect employer health plans. With the regulations, the agencies also released a [Fact Sheet](#) and [Frequently Asked Questions](#). This latest guidance follows the April 27 release of Internal Revenue Service [Notice 2010-38](#), which clarified the tax treatment of mandatory coverage for adult children under the Affordable Care Act. This Legal Alert summarizes the regulations regarding the extension of dependent coverage to age 26 and highlights the provisions of Notice 2010-38 applicable to the rule.

Background

The Affordable Care Act amends the Public Health Service Act (PHSA) to add section 2714, requiring group health plans and health insurance issuers that provide dependent coverage for children to continue that coverage for children up to age 26, regardless of the child's dependent status under Internal Revenue Code (IRC) §152, student status or marital status. Corresponding changes were also made to the IRC and the Employee Retirement Income Security Act (ERISA). The Affordable Care Act also amends IRC §105(b) effective March 30, 2010, to exclude from an individual's gross income any reimbursements received from a health plan for medical care provided to his or her child who has not attained age 27² by the end of the individual's taxable year. IRC §106 contains a parallel exclusion from gross income for employer-provided health plan coverage – *i.e.*, employer contributions or premiums for health coverage. While IRC §106 was not specifically amended by the Affordable Care Act to exclude coverage extended to children under age 27 from income, Notice 2010-38 indicates that the applicable regulations will be revised to add this exclusion.

Although the extension of coverage to children up to age 26 is mandatory for group health plans as of the first plan year beginning on or after September 23, 2010 (the Effective Date), the requirement generally does not apply to grandfathered group health plans until plan years beginning on or after January 1, 2014.³ There is an important exception to the grandfather rule, however. Specifically, to the extent that a child under age 26 is not eligible for coverage under another employer-sponsored group health plan (other than a grandfathered plan), a grandfathered group health plan is required to extend coverage to the child as of the Effective Date.

¹ These agencies include the Internal Revenue Service, the Department of Treasury, the Employee Benefits Security Administration of the Department of Labor, and the Department of Health and Human Services Office of Consumer Information and Oversight.

² Although the PHSA, IRC and ERISA extensions of coverage only cover children up to age 26, the tax law change extends the exclusion from income until the end of the year in which the child attains age 26 to avoid the loss of the tax exclusion as of the child's 26th birthday if the plan is more generous.

³ Click [here](#) for our May 5, 2010, alert on grandfathered health plans.

© 2010 Sutherland Asbill & Brennan LLP. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

Note that the definition of group health plan in the PHSA, IRC and ERISA is the same definition used for the special enrollment and portability rules of the Health Insurance Portability and Accountability Act (HIPAA). Thus, the extension of coverage mandate does not apply to health plans that only provide excepted benefits, such as stand-alone dental or vision plans. In contrast, the income tax exclusion is not limited to coverage and benefits under a group health plan, and the Notice also states that the exclusions apply to retiree health accounts in pension plans (IRC §401(h) accounts) and coverage through voluntary employees' beneficiary associations or for self-employed individuals.

Summary of Guidance

The tri-agency rule and the Notice answer several questions regarding the extension of dependent coverage to adult children and the tax treatment of the extended coverage. Specifically, the guidance clarifies that:

- The federal statute will not supersede any state law requiring the coverage of adult children to the extent that the state law imposes a stricter requirement than that imposed by the Affordable Care Act (presumably, state laws that require coverage beyond age 26);
- Any plan that offers coverage for dependents (including a retiree plan that covers dependents) will be required to cover children up to age 26 effective as of the first plan year beginning on or after September 23, 2010, with an exception for the special rule applicable to grandfathered plans as noted above. Under Notice 2010-38, employees can exclude from income both the cost of coverage and reimbursements made with respect to their adult children beginning March 30, 2010.
- For purposes of the tax exclusions, the term "child" is defined in IRC §152(f)(1) as a son or daughter, stepson or stepdaughter, and a legally adopted (or placed for adoption) child or eligible foster child. In contrast, the regulations do not provide a definition of "child," and the preamble notes that the agencies concluded that plan sponsors should have the flexibility to define this term for purposes of their plans, subject to the other rules below.
- As of the Effective Date, group health plans may no longer condition or deny dependent coverage to children based on student status, residence with the employee, financial support levels, or status as a dependent under IRC §152(a). Notice 2010-38 confirms that coverage and reimbursements received by a participant on behalf of the covered adult child are excludable from the participant's gross income even if the child does not meet the age limit, residency, support, and other dependency tests set forth in IRC §152(c).
- A group health plan may no longer base the plan's definition of "dependent" for purposes of eligibility for dependent coverage on any factor other than the relationship between the child and the participant, such as financial dependence or place of residence.
- Group health plans also may not vary the terms of the plan based on the age of a child, except for children age 26 or older. This means that plans will not be able to require a higher premium, for example, for children between age 18 and age 25, nor can the plan restrict adult children to a limited selection of the benefit options offered under the Plan.
- If a child is eligible for coverage under the grandfathered plans of the employers of both parents, neither plan may exclude the adult child from coverage because the child is eligible to enroll in the plan of the other parent's employer.
- Group health plans are not required to cover spouses of adult children or children of children (employees' grandchildren) receiving dependent coverage. Similarly, Notice 2010-38 provides that the exclusions from income under IRC §105 and §106 do not extend to such coverage unless the individual is otherwise a dependent of the employee.

Transition Rule

The regulations include a transition rule for children who have previously “aged out” under the plan’s terms prior to reaching age 26, or who were older than the plan’s qualifying dependent age when the parent first became eligible to participate in the plan. The regulations require that plans give these children written notice of the availability of coverage and an opportunity to enroll in the plan that lasts at least 30 days. The opportunity and notice must be provided not later than the first day of the first plan year beginning on or after September 23, 2010, and coverage may not begin later than that first day of the plan year. The written notice may be provided to the child through the employee, and may be included in the plan’s open enrollment materials, provided that the notice is prominently displayed.

Adult children enrolling under this transition rule must be treated as special enrollees under HIPAA. Thus, they cannot be required to pay more for coverage than similarly situated individuals who did not lose coverage as a result of the cessation of dependent status. However, if a plan voluntarily opts to allow continued coverage of adult children before being required to do so under the Affordable Care Act, the preamble to the rule indicates that the plan is not required to extend this special enrollment opportunity to adult children who will simply continue under the plan without losing coverage. Finally, children currently covered under COBRA who are eligible for coverage under the transition rule must be given the opportunity to enroll as a dependent of an active employee, and must be provided another opportunity to elect COBRA once they again “age out” of the plan at 26.

Cafeteria Plans

Most plans allow participants to pay the employee share of health care premiums on a pre-tax basis through a cafeteria plan under IRC §125, which provides for the election of certain qualified benefits that are not otherwise includable in gross income of the employee under this express provision. Notice 2010-38 clarifies that the exclusion for coverage and reimbursements from an employee’s gross income under IRC §§105 and 106 for an employee’s child who has not attained age 27 is a “qualified benefit” for purposes of a cafeteria plan election, including a health flexible spending account (FSA) election. Although the cafeteria plan rules currently restrict mid-year changes to cafeteria plan elections to certain specified change in status events, the Notice provides that IRS and Treasury will amend these rules to allow participants to make changes related to the adult child coverage extension, including adding coverage for newly eligible adult children under age 27. The cafeteria plan rules will be amended retroactively to March 30, 2010. Despite the general rule that cafeteria plan document amendments may only be made effective prospectively, cafeteria plans may permit employees to make pre-tax salary reduction contributions immediately for health benefits (including health FSA benefits) for adult children, provided the plan is actually amended to allow the contributions no later than December 31, 2010, and the amendment is made retroactive to the first date in 2010 when employees are permitted to make pre-tax salary reduction contributions to cover children under age 27 (but not earlier than March 30, 2010).

Early Implementation

The Secretary of the U.S. Department of Health and Human Services has asked employer-sponsored health plans to follow the lead of many of the country’s largest insurers and extend coverage to adult children as soon as possible, even prior to the Effective Date. The rule notes that early adoption will not affect the status of grandfathered plans. However, employers considering early implementation should understand that several issues concerning the adult coverage extension remain unclear, including the

effect of early implementation on the special grandfathering rule for collectively bargained plans and the employer's COBRA obligation for children who would not otherwise be covered until the Effective Date.



If you have any questions about this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

Daniel M. Buchner	202.383.0869	daniel.buchner@sutherland.com
Adam B. Cohen	202.383.0167	adam.cohen@sutherland.com
Jamey A. Medlin	404.853.8198	jamey.medlin@sutherland.com
Alice Murtos	404.853.8410	alice.murtos@sutherland.com
Joanna G. Myers	202.383.0237	joanna.myers@sutherland.com
Robert J. Neis	404.853.8270	robert.neis@sutherland.com
Vanessa A. Scott	202.383.0215	vanessa.scott@sutherland.com
W. Mark Smith	202.383.0221	mark.smith@sutherland.com
William J. Walderman	202.383.0243	william.walderman@sutherland.com
Carol A. Weiser	202.383.0728	carol.weiser@sutherland.com