

Health Care Reform: Dependent Coverage for Children under age 27

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The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively referred to as the "Act"), included a mandatory extension of coverage for employee's children in plans that provide coverage for children. The Departments of Treasury, Labor and Health and Human Services (HHS) have recently issued several pieces of guidance that together provide employers with much needed direction on how to implement this new requirement.

Dependent Coverage Changes

Prior to the Act, employer-provided payments or reimbursements for the medical care expenses of an employee's dependents were excluded from the employee's gross income only if the dependents were tax dependents under Section 152 of the Internal Revenue Code. Under Code Section 152, generally children are dependents only if they are under the age of 19, or students under age 24, and only if they meet certain other conditions such as residency and financial support tests. Therefore, to avoid imputing income for employer-provided coverage many, if not most, plans that provide coverage for employees' children limited such coverage to children that are Code Section 152 tax dependents.

Joint interim regulations released on May 10, 2010 by the Departments of Treasury, Labor and HHS address the Act's general requirement that a group health plan or health insurer providing dependent coverage for children must, beginning with the plan's first plan year beginning on and after September 23, 2010, make that coverage available for all children until age 26 regardless of whether the child is the employee's Code Section 152 tax dependent. Therefore, plan provisions that specify eligibility for dependent coverage will have to be amended so that a child's eligibility is only conditioned on age and relationship with the employee, and not on the traditional tax dependent definition.

For plan years beginning before January 1, 2014, a 'grandfathered' plan (generally a plan that was in effect on March 23, 2010) may limit coverage of adult children to those adult children who are not eligible for an employer-sponsored health plan other than a parent's plan. Currently, there is little guidance on how to maintain a plan's grandfathered status, so employers wishing to maintain a plan's grandfathered status should review with legal counsel or delay any plan changes or amendments, other than those necessary to comply with the Act, until further guidance is issued.

In addition, the interim regulations provide that a child who is under age 26 and was not previously eligible or whose coverage was previously denied or terminated must be given an opportunity to enroll in the health plan no later than the first day of the first plan year beginning after September 23, 2010. The enrollment period must be at least 30 days long and provide for enrollment in coverage as of the first day of the plan year beginning on or after September 23, 2010. Notice of this enrollment opportunity must be provided to the child or to the employee on the child's behalf, and may be included in general open enrollment materials if the notice is prominent. Any child that enrolls during this special enrollment period must be treated as a special enrollee under HIPAA and be offered all benefit options available to similarly situated individuals who did not lose coverage due to cessation of dependent status. The plan cannot charge the adult child more for coverage than similarly situated individuals.

Taxation Changes

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The Act also attempted to extend the historical tax treatment of employer-provided dependent medical coverage to coverage for adult children. Effective March 30, 2010, payments and reimbursements for medical care under employer-provided health plans provided to an employee's child who has not reached age 27 by the end of the employee's taxable year are excluded from the employee's income, regardless of whether the child is a tax dependent under Code Section 152(a). IRS Notice 2010-38 allows employers to assume that an employee's taxable year is the calendar year and rely on the employee's representation as to the child's date of birth. Further, Notice 2010-38 clarifies that coverage and reimbursements provided for children under age 27 are excluded from the definition of wages for purposes of FICA, FUTA, and income tax withholding.

Although the Act did not amend Code Section 106, which excludes the cost of coverage (as opposed to payments or reimbursements from an employer-provided plan) from an employee's gross income, Notice 2010-38 announced the IRS and Treasury's intention to amend the regulations under Code Section 106 retroactively to March 30, 2010 to provide that coverage for an employee's child under age 27 is excluded from the employee's gross income. As a result, employers may choose to immediately extend coverage under their accident and health plans to employee's children under age 27 without adverse tax consequences, and employers that have been voluntarily providing extended dependent coverage can stop imputing income to employees immediately.

Cafeteria Plan Changes

The Act also makes conforming amendments to the dependent definition for purposes of cafeteria plans, health FSAs, and HRAs. The Act makes eligible with respect to employee's children under the age of 27 (i) pre-tax payment of accident and health plan premiums through a cafeteria plan, and (ii) reimbursement of eligible expenses from an FSA or HRA. Employers may immediately begin permitting employees on and after March 30, 2010 to make pre-tax salary reduction contributions through their cafeteria plans for accident or health benefits of their children under age 27.

Although the Act did not amend the cafeteria plan change in election rules, the IRS and Treasury also announced that they will amend the regulations, retroactively to March 30, 2010, to extend the list of eligible change in status events for cafeteria plans, FSAs and HRAs to include becoming newly eligible for coverage or extended coverage for nondependent children under age 27. This is generally consistent with the treatment of this new enrollment right as a HIPAA special enrollment right and will permit employees to change their cafeteria plan elections to pay a newly enrolled adult child's premium on a pre-tax basis.

As a result of these changes, cafeteria plans will have to be amended no later than December 31, 2010 retroactively to the first day that such contributions were allowed to reflect the new eligibility and election change provisions.

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