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MEMORANDUM 2010-11

Health Care Reform's Expansion of Coverage to Over-age Dependents

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As we all know by now, the Health Care Reform Law ([H.R. 3590](#) and [H.R. 4872](#)) mandates that all health plans, whether grandfathered or not, must extend health care coverage to eligible dependents to age 26. In recent days we have seen both the [IRS Notice \(2010-38\)](#) and the [Interim Final Rule](#), jointly issued by the IRS, Health and Human Services (HHS), and the Department of Labor (DOL). The purpose of this Memorandum is to provide you with an overview of the rulemaking as well as a discussion of health plan issuers' offer for early adoption of the Age 26 Mandate.

Discussion of the Interim Final Rule

On Monday, May 10, 2010, the IRS, DOL, and HHS issued an all important Interim Final Rule (with request for comments) for group health plans, individual policies, and health insurance issuers, answering many of the questions regarding the scope of the expanded coverage.

1. **Definition of Dependents.** The single most dominant issue is who must be allowed coverage. The rulemaking defines dependents as those who are:
 - Not required to live at home;
 - Not required to be a dependent on the employee's tax return; and,
 - Not required to be a student; and,
 - Merely to be a child of the participant (including adopted children).
2. **The Marriage Issue and Access to Other Coverage.** Additionally, the new Rule applies to married and unmarried children. Between now and January 1, 2014, for purposes of grandfathered plans only, adult children will not be eligible for coverage if they have access to an employer-provided health plan. This exception does not apply to non-grandfathered plans. As of January 1, 2014, all plans must not deny coverage due to availability of group health coverage elsewhere. It is important note that the Interim Final Rule only requires coverage for the dependent, not the spouse of the dependent (and, by extension, the dependent's domestic partner).



3. **Domestic Partners.** Since domestic partnerships are not recognized under federal law, the Interim Final Rule does not mandate coverage for domestic partners. Plans which cover domestic partners whether voluntarily or in compliance with state laws may consider eligible dependents as eligible but are not required to under the Interim Final Rule.
4. **Employee Contributions.** The employer must charge the same premium contribution for adult children as it does for other similarly situated dependents.
5. **Eligibility.** The criteria that issuers may use for determining eligibility are limited to the relationship between child and the plan participant. Premiums cannot vary based on age or residency or pre-existing conditions.
6. **Special Enrollment Rights.** For purposes of the election, and as a special open enrollment right under the Health Insurance Portability and Portability Act (HIPAA), the dependent must be offered all the benefit packages that are available to similarly situated employees who have not lost coverage. If the parent is not enrolled, but otherwise eligible to enroll, the plan must allow the parent to enroll. Additionally, if already enrolled, the parent can switch package options at the time of the dependent's election.
7. **COBRA.** If the over-age dependent has elected COBRA, he/she may elect coverage under the active plan and drop COBRA coverage. At the time the dependent loses coverage at age 26 (or later) he/she will have full COBRA rights restored (i.e. 36 months, etc.).
8. **Internal Revenue Code Section 152.** The expanded definition of dependents under the Health Care Reform Law is limited to health care plans only. The definition of dependents under IRC Section 152 (i.e. Qualifying Child, Qualifying Relative, etc.) remains in effect for all other purposes.
9. **Access to Coverage.** As you know, most health insurance issuers are offering to cover adult children to age 26, as of June 1, 2010, which is prior to the actual compliance date. Plans must comply, whether grandfathered or not, no later than the first day of the plan year beginning on or after September 23, 2010.
 - **Currently on the plan.** Issuers will continue coverage automatically for adult children currently covered by a health plan, but who might otherwise have lost eligibility due to age or loss of student status (aged out) during the current plan year, unless they employer opts out.
 - **Dependents who have already aged out.** Issuers will provide coverage to those adult children who have aged out previously and who are currently under age 26. Coverage will begin at the time of an open enrollment, whether through a special open enrollment period or at annual open enrollment prior to the plan year beginning before September 23, 2010.
10. **Notice Requirement.** The Rule requires that either the issuer or the plan sponsor must provide notice of the availability of coverage to all plan participants (primary subscribers for purposes of individual plans). Plan sponsors may include the notice in the open enrollment materials, as long as the statement is prominent. We may or may not see a DOL model notice.



Discussion of IRS Notice 2010-38

The Health Care Reform Law also contains a modification in the tax treatment of health care coverage for over-age dependents.

1. **Removal of Imputed Income Tax.** The law removes the imputed income tax requirements on over-aged dependents up to age 27, relieving employers from having to impute income for employer-provided health coverage to children over-age 19 who do not meet the definition of qualifying child, which requires that they be full time students and living with the taxpayer (IRC Section 152(f)(1)).
2. **Effective Date.** The relief applies to coverage provided or continuing to be provided after March 30, 2010. Employers must treat coverage provided prior to March 30, 2010 as subject to imputed income. Please note that whether before or after March 31, 2010, the cost of coverage is not subject to FICA or FUTA taxes.
3. **The Meaning of "Age 27."** For purposes of this new law, the coverage provided is tax free through December 31 (end of the taxpayer's tax year), for the year in which the participating dependent turns 27.
4. **Limited Scope of Rule.** Technically speaking, this new law applies to IRC Sections 105 (tax free benefits), 106 (non-taxable employer contributions), and 125 (cafeteria plans). By not amending IRC Section 152 (definition of dependents), Congress makes it clear that this imputed income exclusion only applies to group health plan coverage.
5. **Cafeteria Plan: Status Change.** The new law modifies cafeteria plan rules to permit pre-tax contributions for coverage applicable to over-age dependents and to permit tax free benefits for over-age dependents under a health care spending account. Cafeteria plan regulations currently do not permit the addition of an over-age dependent as an opportunity to change an FSA election amount. This IRS Notice says that the IRS and Treasury intend to amend regulations (1.125-4) effective retroactively to March 30, 2010 to treat the addition of coverage for an over-age dependent up to age 27 as a qualifying status change. The employer can choose to permit the change in election but is not required to do so.
6. **State Laws.** Certain states require insured plans to provide health coverage to over-age dependents beyond age 27, the limit permitted on a tax-free basis under federal law. Federal income tax rules will require the inclusion of imputed income for coverage provided beyond age 27. States with these laws have their own separate state income tax rules.

In Summary

All group health plans, whether insured or self-insured, must permit this expansion of coverage to over-age dependents to age 26, as of the first day of their plan year beginning on or after September 23, 2010. The employer may choose to implement the Rule prior to that date.



Action Plan

1. Age 26 Eligibility

- a. Review the Interim Final Rule at <http://www.dol.gov/ebsa/pdf/dependentcoverage.pdf>.
- b. Confer with insurers (TPAs and stop loss carriers, as applicable) about changes in eligibility, open enrollment requirements, etc.
- c. Determine what changes the plan will make.
- d. Provide notices to all participants regarding the availability of the extended coverage.
- e. Consult with your benefits professionals as needed.

2. Taxation

- a. If an employer wants to permit a new election under the cafeteria plan with the addition of an over-age dependent, he must amend the cafeteria plan by the end of the current plan year. Although it is permitted here, the amendment appears to contradict the IRS proposed rule prohibiting retroactive cafeteria plan amendments.
- b. Employers must impute income for health care coverage provided to non-qualifying dependents any time prior to March 30, 2010. The imputed income amount will appear on W-2s issued for 2010 and prior years.
- c. Employers should not collect FICA or FUTA taxes.

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