



Part I: Employee Benefits May 2010, Volume 2

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IRS Allows Employers the Option to Offer Health Coverage To Adult Children in 2010

In our recent Alert, “Health Care Reform: What Employers Need to Know Now,” we described the provisions of the Health Care Reform Law that: 1) provide for the exclusion from income for federal income tax purposes, effective March 30, 2010, of employer provided health care coverage for children who will not attain age 27 as of the end of the taxable year, and 2) require health plans to offer coverage to children under age 26, subject to certain restrictions, commencing in the first plan year beginning after September 23, 2010 (which in many instances will be the plan year beginning January 1, 2011).

Some employers have expressed interest in offering coverage to these adult children prior to the required effective date. Initially, it was unclear whether or not such “early compliance” would be permitted under existing Section 125 cafeteria plan rules. In response, on April 27, the IRS issued guidance, Notice 2010-38 (the “Notice”), on how these provisions may be implemented by employers with respect to their plans during 2010 and prior to the required effective date. In short, the IRS has made it clear that it is permissible to change a plan’s rules during 2010 to permit the coverage of children with respect to whom the tax exclusion has become available as a result of the law change. In issuing this Notice, the government is encouraging employers to make such changes before they become mandatory.

Three specific points with respect to the Notice are worth highlighting:

1. The income tax exclusion applies for a child through the end of the taxable year in which the child reaches age 26. In contrast, the requirement to offer coverage to a child in a plan only extends to the date the child reaches age 26. (Through 2013, grandfathered plans can further condition coverage on such child not having been offered employer provided coverage through the child’s employer.) The Notice makes it clear that it is permissible (but not mandatory) for a health plan to continue the coverage for the same period of time the child is eligible for the exclusion, i.e. through the end of the year in which the child reaches age 26.
2. For some participants, covering an adult child for the remainder of 2010 will require that they modify their cafeteria plan election, which generally is not permitted mid-year unless there is a “change in status,” as defined under the cafeteria plan regulations. The Notice states that the Treasury intends to amend these regulations, retroactive to March 30, 2010, to include “change in status” events affecting children under age 27, including becoming newly eligible for coverage or eligible for coverage beyond the date on which the child otherwise would have lost coverage. Accordingly, and effective immediately, it is permissible for employers to allow participants to make previously prohibited mid-year elections to add or continue coverage of a newly-eligible child. While an employer will have to amend its cafeteria plan



to permit these elections, the amendment can be made retroactively, as long as it is made by December 31, 2010.

3. If an employer chooses to expand coverage in 2010, there are some choices as to how it implements that expansion, such as whether to continue coverage only to age 26 or through the end of the year, whether to allow new enrollments or only continuations of children who would otherwise have been dropped, and whether to allow a new flexible spending account election for the remainder of 2010. Before making these decisions, it is important that an employer check with its insurer or third party administrator to verify that its proposed design change is workable.

The bottom line is that employers may act now to expand coverage to include adult children who will not reach their 27th birthday during 2010, and to permit participants to make mid-year cafeteria plan elections to cover such children. Such changes will require some planning now, but the document amendments can be made as late as December 31, 2010.

Clarification on Reimbursable Expenses from FSAs, HSAs and HRAs:

On another note, we have received feedback about the description in our Alert of the changes affecting flexible spending accounts (FSAs), health savings accounts (HSAs), and healthcare reimbursement accounts (HRAs) in 2011. To clarify, the only change to the medical expenses that may be reimbursed from those accounts is with respect to drug cost reimbursements. Beginning in 2011, the only drugs that may be reimbursed from FSAs, HSAs and HRAs are drugs that have been prescribed (without regard to whether such drugs are available without a prescription) and insulin. The reimbursement rules for other medical expenses, such as co-pays for doctor visits, remain unchanged. We have edited the on-line version of "Health Care Reform: What Employers Need to Know Now," to clarify this point.

QUESTIONS OR ASSISTANCE

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