

CLIENT ALERT

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Additional Permitted Election Changes for Health Coverage under a Section 125 Cafeteria Plan

The IRS introduced Notice 2014-55 which addresses two specific situations in which a participant may wish to drop coverage under their § 125 cafeteria plan and enroll in a Qualified Health Plan (QHP) through the Health Insurance Marketplace.

This is a good time once again to remind our clients that if you are allowing your employees to pay for their contributions on a pre-tax basis then you are offering a § 125 cafeteria plan as defined by the IRS and must have the required documentation, also called a Section 125 Premium Only Plan. Please contact your accountant, payroll company or us if you are not sure if you are in compliance.

REDUCTION IN HOURS

The first situation involves an employee whose hours of service are reduced so that the employee is expected to average less than 30 hours of service per week but for whom the reduction does not affect the eligibility for coverage under the employer's group health plan. (This may occur during a variable hourly employee's stability period).

Under the ACA, an applicable large employer is subject to an assessable payment if the employer does not offer minimum essential coverage to its full time employees and one or more full time employees receive the premium tax credit in the Marketplace.

Under Treas. Reg. § 54.4980H-3(d), an applicable large employer may use the look-back measurement method to determine the status of an employee as full-time or not full-time. Under the look-back measurement method, for purposes of § 4980H, an employee determined to be full-time based on hours of service during a measurement period must be treated as a full-time employee during a subsequent stability period, regardless of the employee's hours of service during the stability period. Thus, under the look-back measurement method, an employee could have a change in employment status (for example, a change from a full-time position to a part-time position) resulting in a reduction in hours that does not change the employee's status as a full-time employee for purposes of § 4980H, at least for some period of time. The change in employment

status would not result in a change in an employee's eligibility for the group health plan. Because the change in employment status would not result in a change in the employee's eligibility for the group health plan the cafeteria plan could not allow the employee to change the employee's election under the cafeteria plan during the period of coverage.

SPECIAL ENROLLMENT RIGHTS/OPEN ENROLLMENT

The second situation involves an employee participating in an employer's group health plan who would like to drop coverage under the group health plan and purchase coverage through a Marketplace without either having a period of duplicate coverage under both the employer's plan and coverage purchased through a Marketplace or a period of no coverage at all.

Pre-tax elections under a § 125 cafeteria plan are irrevocable except under specific circumstances, such as a change in employment status that results in a change in the individual's eligibility for coverage or Special Enrollment Rights. Special Enrollment Rights are provided when there exists loss of other coverage, certain family events and a spouse's or other party's open enrollment period. It is important to note that the open enrollment period of the Marketplace up until now was not a Special Enrollment Right under a § 125 cafeteria plan.

Under the current change in status rules a cafeteria plan may not allow an employee to drop coverage under the group health plan during the plan year solely to enroll in a QHP through a Marketplace. This is not an issue for calendar year plans as much as for plans that renew on any other day other than January 1. For calendar year plans, an employee may drop coverage during the plan's open enrollment and pick up coverage during the Marketplace open enrollment, such that the group coverage ends at midnight on 12/31 and the Marketplace coverage begins at 12:01 am on 1/1.

However, an individual enrolled through a cafeteria plan in a group health plan with a non calendar plan year will likely not be able to synchronize the change in coverage to avoid an overlapping period of coverage or a period without coverage because the open enrollment period rules for Marketplaces do not permit the purchase of coverage commencing upon the end of the non calendar cafeteria plan year. In other words, a non calendar year open enrollment is not considered a Special Enrollment Period by the Marketplace.

Cafeteria plans allow employees to change coverage options during the plan year and to make a new election that corresponds with Special Enrollment Rights as defined by the IRS regulations that govern Section 125 plans. These Special Enrollment Rights relate only to enrollment in another group health plan, not to enrollment in a QHP offered through a Marketplace. Thus, a cafeteria plan may not allow an employee to drop coverage and enroll in a QHP offered through a Marketplace as the result of an employee's eligibility to enroll in a QHP during Special Enrollment Period for the Marketplace, even though most of the events giving rise to special enrollment rights under a § 125 cafeteria plan correspond to the events giving rise to Special Enrollment Periods for a Qualified Health Plan.

For example, marriage is a Special Enrollment event under both a § 125 cafeteria plan and the Marketplace. If an employee is covered as a single employee under his employer's § 125 cafeteria medical plan, when he marries, it becomes a special enrollment right to add his wife or drop his coverage and become covered under her employer's plan. Up until now, it was not an opportunity to drop his employer's plan and enroll in a QHP through a Marketplace.

However, in the case of an event such as a birth or marriage, it may be more advantageous for some individuals to enroll themselves and their families in a QHP rather than to add family members to an employer's group health plan. To permit access to QHPs in these cases, this notice permits a cafeteria plan to allow a participating employee to revoke an election in order to obtain coverage through a Marketplace.

GUIDANCE

A cafeteria plan may allow an employee to prospectively revoke an election of coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in § 5000A(f)(1)) provided the following conditions are met:

Conditions for revocation due to reduction in hours of service

(1) The employee has been in an employment status under which the employee was reasonably expected to average at least 30 hours of service per week and there is a change in that employee's status so that the employee will reasonably be expected to average less than 30 hours of service per week after the change, even if that reduction does not result in the employee ceasing to be eligible under the group health plan; and

(2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in another plan that provides minimum essential coverage with the new coverage effective no later than the first day of the second month following the month that includes the date the original coverage is revoked.

Conditions for revocation due to enrollment in a Qualified Health Plan

(1) The employee is eligible for a Special Enrollment Period to enroll in a QHP through a Marketplace pursuant to guidance issued by the Department of Health and Human Services and any other applicable guidance, or the employee seeks to enroll in a QHP through a Marketplace during the Marketplace's annual open enrollment period; and

(2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee and any related individuals who cease coverage due to the revocation in a QHP through a Marketplace for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

In both instances, a cafeteria plan may rely on the reasonable representation of an employee that the employee and related individuals have enrolled or intend to enroll in another plan that provides minimum essential coverage. New coverage must begin no later than the first day of the second month following the month that includes the date the original coverage is revoked.

The consistency requirement that applies to mid-year cafeteria plan election changes is not affected. So midyear election changes must be consistent with the qualifying event.

AMEND PLAN DOCUMENTS

To allow the new permitted election changes, a cafeteria plan must be amended to provide for such election changes. The amendment must be adopted on or before the last day of the plan year in which the elections are allowed, and may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the guidance under the notice and the employer informs participants of the amendment. In addition, a cafeteria plan may be amended to adopt the new permitted election changes for a plan year that begins in 2014 at any time on or before the last day of the plan year that begins in 2015. However, in no event may retroactive elections to revoke coverage be allowed.

EFFECTIVE DATE AND PLAN AMENDMENTS

The guidance in this notice is effective on September 18, 2014. The Treasury Department and the IRS intend to amend Treas. Reg. § 1.125-4 to reflect the guidance in this notice. Taxpayers may rely on the guidance in this notice pending further guidance.

<http://www.irs.gov/pub/irs-drop/n-14-55.pdf>

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