

Health Reform

Dependent Coverage

Interim Final Rules and IRS Guidelines for Adult Dependent Coverage

The Patient Protection and Affordable Care Act (the Act and subsequent Health Care and Education Reconciliation Act referred to herein collectively as “PPACA”) requires group health plans offering dependent coverage to extend such coverage until dependents reach age 26 (referred to herein as “adult dependents”). The provision is effective for policy (individual) and plan (group) years starting on or after Sept. 23, 2010. If the plan is grandfathered, the provision only applies if the adult dependent does not have other employer-sponsored coverage. After Jan. 1, 2014, the adult dependent must be offered coverage regardless of access to other employer-sponsored coverage.

Interim final rules concerning adult dependent coverage were issued on May 10, 2010, and confirm that factors other than the child/participant relationship may not be used for purposes of determining extended eligibility (e.g., financial dependency, residency, student status, marital status). The interim final rules also provide that cost-sharing amounts and benefits for dependent coverage cannot vary based on the age of the child, except for children age 26 or older. In the case of an adult dependent who is eligible for coverage under the plans of the employers of both parents, neither plan may exclude the adult dependent from coverage based on the fact that the adult dependent is eligible for other employer-sponsored coverage (applicable to grandfathered plans). Finally, the FAQs clarify that although the requirement to provide dependent coverage applies only until the 26th birthday, if coverage extends beyond that date, the value of the coverage may be excluded from the employee’s income for the full tax year (generally the calendar year) in which the child turns 26 years old.

The interim final rules establishes a requirement that a plan or issuer must give an adult dependent an opportunity to enroll for at least 30 days, regardless of whether the plan offers an open enrollment period. Any adult dependent enrolling in group health plan coverage must also be treated as a special enrollee under HIPAA. Accordingly, the adult dependent must be offered all the benefit packages available to similarly situated individuals who did not lose coverage (or were denied coverage) based on cessation of dependent status.

An example in the Interim Final Rules illustrates that the plan must provide an opportunity for the parent to enroll in addition to the adult dependent. Another example illustrates that an adult dependent who qualifies for enrollment under this provision who is covered under a COBRA continuation provision must be given the opportunity to enroll as an adult dependent of an active employee (i.e., other than as a COBRA-qualified beneficiary). In this situation, if a child loses eligibility due to a qualifying event (including aging out at age 26) the child has another opportunity to elect COBRA continuation coverage.

On a related note, the IRS issued IRS Notice 2010-38 on April 27, 2010, (the “Notice”) on the favorable tax treatment for coverage of adult dependents. Generally, coverage of non-tax dependents equates to taxable income to the employee. The PPACA eliminates the tax burden for coverage of adult dependents, even if the child is not a tax dependent. The PPACA did not change the definition of tax dependent, but amended Section 105(b) of the Internal Revenue Code (IRC), which provides an exclusion for amounts reimbursed for medical expenses relating to the employee, their spouse and their tax dependents. Section 105 generally applies to self-funded plans. Section 106, which was not amended by the PPACA due to oversight, applies to fullyinsured plans. The Notice clarifies that the tax-favored status of adult dependent coverage applies to Section 105 and Section 106 of the IRC.

The non-taxability of adult child coverage was made effective retroactive to March 30, 2010. While the PPACA only requires plans to cover adult children until age 26, the tax-favored status applies through the calendar year in which the adult child attains age 26. The retroactive date is important for employers offering fullyinsured coverage in one of the states that requires coverage of older dependents. The employers in those states may now treat adult dependent coverage as tax-free for purposes of federal income tax in accordance with the guidelines outlined in Notice 2010-38.

The Notice also clarifies that the IRS and Treasury will amend the regulations applicable to cafeteria plans to permit employees to change their elections mid-year and add coverage for adult children when the child becomes eligible for coverage due to PPACA. The

employers that choose to allow mid-year elections must amend their plan documents, but the plan has until Dec. 31, 2010, to make the plan amendment. The plan amendment should be retroactive to the first date that the employer allowed an employee to make a mid-year election change.

The Notice also clarified that the IRS and Treasury also intended to amend the cafeteria plan regulations to clarify that expenses for adult children may be reimbursed tax-free from a health FSA or health reimbursement account. The tax-free status was not extended to health savings account reimbursements for adult children.

Finally, the Notice clarified that adult child coverage may be provided through a plan that is funded by a VEBA (voluntary employees' beneficiary association) or through a Section 401(h) Retiree Medical Account, and the deduction for premium payments made by self-employed individuals includes amounts expended for adult children. The tax-free nature extends to FICA, FUTA and Railroad Retirement Tax.

Frequently Asked Questions

Q: What plans are required to extend dependent coverage up to age 26?

A: The Affordable Care Act requires plans and issuers that offer dependent coverage to make the coverage available until a child reaches the age of 26. Both married and unmarried children qualify for this coverage. This rule applies to all plans in the individual market and to new employer plans. It also applies to existing employer plans unless the adult child has another offer of employer-based coverage (such as through his or her job). Beginning in 2014, children up to age 26 can stay on their parent's employer plan even if they have another offer of coverage through an employer.

Q: I'm a young adult under the age of 26 and I'm on my parents' plan now, but I'm scheduled to lose coverage soon. How can I keep my health insurance?

A: You have a number of options. First, check with your insurance company. Private health insurance companies that cover the majority of Americans have volunteered to provide coverage for young adults losing coverage as a result of graduating from college or aging out of dependent coverage on a family policy. This stop-gap coverage, in many cases, is available now. Second, watch for open enrollment. Young adults may qualify for an open enrollment period to join their parents' family plan or policy on or after Sept. 23, 2010. Insurers and employers are required to provide notice for this special open enrollment period. Watch for it or ask about it. Finally, expect an offer of continued enrollment for plans that begin on or after Sept. 23, 2010. Insurers and employers that sponsor health plans will inform young adults of continued eligibility for coverage until the age of 26. Young adults and their parents need not do anything but sign up and pay for this option.

Q: Now that the regulation is published, are plans required to immediately enroll eligible young adults in their parents' plan?

A: No. The law says that the extension of dependent coverage for children is effective for plan years beginning on or after six months after the enactment of the law — that means plan years beginning on or after Sept. 23, 2010. However, the administration has urged insurance companies and employers to prevent a gap in coverage for young adults aging off of their parents' policy prior to this effective date. To date, over 65 insurers have volunteered to do so. You should check with your insurance company to see if they are offering this coverage option.

Q: Will young adults be given a special chance to enroll after Sept. 23, 2010?

A: Yes. For plan or policy years beginning on or after Sept. 23, 2010, plans and issuers must give children who qualify an opportunity to enroll that continues for at least 30 days, regardless of whether the plan or coverage offers an open enrollment period. This enrollment opportunity and a written notice must be provided not later than the first day of the first plan or policy year beginning on or after Sept. 23, 2010. Some plans may provide the opportunity before Sept. 23, 2010.

Q: Will young adults have to pay more for coverage or accept a different benefit package?

A: Any qualified individual must be offered all of the benefit packages available to children who did not lose coverage because of loss of dependent status. The qualified young adult cannot be required to pay more for coverage than similarly situated individuals who did not lose coverage due to the loss of dependent status.

Q: Can plans or issuers who offer dependent coverage continue to impose limits on who qualifies based upon financial dependency, marital status, enrollment in school, residency or other factors?

A: No. Plans and issuers that offer dependent coverage must provide coverage until a child reaches the age of 26. There is one exception for group plans in existence on March 23, 2010. Those group plans may exclude adult children who are eligible to enroll in an employer-sponsored health plan, unless it is the group health plan of their parent. This exception is no longer applicable for plan years beginning on or after Jan. 1, 2014.

Q: Does the adult child have to purchase an individual policy?

A: No. Eligible adult children wishing to take advantage of the new coverage will be included in the parents' family policy.

Q: Are plans or issuers required to provide coverage for children of children receiving the extended coverage?

A: No.

Q: Why is there a special exception for group plans in existence on March 23, 2010?

A: The goal of the legislation is to cover as many young adults under the age of 26 as possible with the least amount of burden. If a young adult is eligible to purchase other employer-based health insurance such as through her job, the law does not require the parent or parents' plan to enroll that child if the parents' plan is a grandfathered health plan (i.e., in existence on March 23, 2010). Of course, all group plans have the option to cover all adult children until the age of 26 or beyond. In 2014, this exception will no longer apply.

Q: What happens if a young adult under the age of 26 is not eligible for employer-sponsored insurance and both parents have separate plans that offer dependent coverage?

A: Neither parent's plan can deny coverage.

Q: Does the law apply to plans or issuers that do not provide dependent coverage?

A: No. There is no federal requirement compelling a plan or issuer to offer dependent coverage at this time. However, the vast majority of group health plans offer dependent coverage and many family policies exist in the individual market.