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HEALTHCARE REFORM

EXTENSION OF NON-TAXABLE HEALTH CARE COVERAGE FOR CHILDREN UP TO AGE 26

The Healthcare Reform Act extends group health plan coverage to children up to age 26. In addition, it amends the Internal Revenue Code to extend the income exclusion for health plan coverage to include coverage for the employee's child through the calendar year of the child's 26th birthday.

Background and Guidance

On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act, and on March 30, 2010, he signed the Health Care Reconciliation Act (referred to collectively as the "Healthcare Reform Act"). The Healthcare Reform Act extends coverage for children up to age 26. In addition, it amends the Internal Revenue Code to extend the income exclusion for coverage for children through the calendar year of their 26th birthdays. On May 13, 2010, the Departments of Labor and Health and Human Services and the Internal Revenue Service issued interim final regulations on the coverage requirement. On May 17, 2010, the Internal Revenue Service issued Notice 2010-38, which interprets the income tax exclusion.

Coverage for Children Up to Age 26: General Rules

The Healthcare Reform Act requires that group health plans that provide coverage for dependents must provide coverage for "children" up to age 26. The requirement is effective for plan years beginning on or after September 23, 2010; for calendar year plans, the requirement goes into effect for the January 1, 2011 plan year. For this purpose, a child includes:

- the employee's son, daughter, stepson, or stepdaughter,
- a child who is legally adopted or a child placed for adoption, and
- a foster child who is placed with the employee by an authorized placement agency, or by court order.

"Child" does not include a grandchild or a child's spouse. The plan can no longer require that the child be the employee's dependent. As a result, the plan cannot impose the customary criteria, such as whether the child is a student, resides with the employee, is unmarried, or has access to other coverage. The only requirement, without regard to the child's age (until age 26), is the relationship of the individual to the employee. Thus, a plan cannot require that a minor child be the employee's dependent (i.e., live with the employee, etc.). However, a "grandfathered plan" (generally, a plan that was in existence on March 23, 2010), can exclude a child who is eligible for coverage under the child's employer's plan, but only until the first plan year beginning on or after January 1, 2014.

The regulations also provide that the plan cannot vary the terms of coverage based on the child's age and cannot impose a higher premium for an adult child. The child's coverage must be subject to the coverage and premium structure that apply generally.

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Transition Rule for Children Without Current Coverage

The guidance provides a transition rule for adult children who lost, or who never had (e.g., because the parent was hired when the child was no longer eligible) coverage. The plan must provide a written notice and a period of at least 30 days to enroll. Coverage must be effective as of the first day of the plan year (for calendar year plans, January 1, 2011), even if the coverage must be provided retroactively. The regulations provide that the notice can be included in open enrollment materials so long as the notice is prominent.

Observation: Employers who intend to include the notice in their open enrollment periods should schedule the distribution of the materials and the timing of the open enrollment period so that employees will have a period of at least 30 days to select coverage for their adult children.

The newly covered child is treated as a HIPAA special enrollee, with access to all coverage options at the same cost as other similarly situated individuals.

The regulations include several examples to illustrate how the transition rule works. If a child is qualified for enrollment under the Healthcare Reform Act, but the parent is not covered, the plan must provide an opportunity for the parent to enroll. In addition, the plan must permit the parent to change benefit options if the parent wishes to enroll the child in another option for which the child is eligible. If the child is enrolled under COBRA (because the child previously lost coverage), the plan must permit the child to enroll as the child of an active employee. When such a child later loses coverage, the child has another opportunity to elect COBRA.

Tax Treatment – Income Exclusion

Under these new rules, the cost of coverage for a child is excluded from the employee's income through the end of the calendar year of the child's 26th birthday. In this respect, the income exclusion is broader than the coverage requirement. Coverage can cease as of the child's 26th birthday, whereas the plan can be designed to cover the child through the end of that calendar year, and the parent can exclude the cost of coverage from the parent's income. IRS Notice 2010-38 clarifies that the employee income exclusion is effective for coverage on or after March 30, 2010. As a result, the exclusion applies both to the required coverage beginning generally in 2011 and to voluntary coverage in 2010.

The Notice provides that a health flexible spending account (FSA) can permit reimbursement of expenses for an adult child and can permit an employee to make a mid-year election change in 2010 to increase health FSA contributions. However, the plan must be amended by December 31, 2010 to provide for pre-tax coverage for adult children and to provide for pre-tax reimbursement of their medical expenses and, possibly, to include the mid-year election change. The Notice states that the IRS intends to amend the regulations under section 125 to include new coverage for an adult child as an event that will permit a mid-year change.

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