

Health Plans: What's Next?

Drinker Biddle's
Health Care Reform Update
for Employee Benefit Plans



New Guidance Issued On Implementing “Adult Child” Dependent Coverage Mandate

Under the Patient Protection and Affordable Care Act, signed by President Obama on March 23, 2010, and the related Health Care and Education Reconciliation Act of 2010, signed on March 30, 2010 (together, the Health Care Reform Law), group health plans that provide dependent coverage must offer such coverage to adult children who have not yet turned 26 years of age. The Health Care Reform Law *also* expands the tax-favored treatment of the coverage of adult children under employer-sponsored group health plans. Two pieces of recent guidance – Internal Revenue Service (IRS) Notice 2010-38 issued April 27, 2010, and interim final rules jointly issued by the IRS, Department of Labor (DOL) and Department of Health and Human Services (HHS) released on May 10, 2010, and published on May 13, 2010 – provide plan sponsors with much of the information needed to implement the new mandate and the related changes to the tax treatment of such coverage.

This new guidance is summarized below. For more information regarding the mandate to provide coverage to adult dependents generally, [click here](#) to view our April 14, 2010, alert, “Health Care Reform Bill Requires Group Health Plans to Cover ‘Adult Child’ Dependents.”

Drinker Biddle Note: The mandate to provide adult child coverage applies only to “group health plans” (as defined for HIPAA portability purposes), while the new, more favorable tax treatment applies more broadly:

Type of Plan	Does Coverage Mandate Apply?	Does Expanded Favorable Tax Treatment Apply?
Medical	Yes	Yes
Dental (stand-alone, limited scope)	No	Yes
Vision (stand-alone, limited scope)	No	Yes
Health Care Flexible Spending Account (Health FSA)	No (if HIPAA Excepted)	Yes (whether or not HIPAA Excepted)
Health Reimbursement Account (HRA)	Yes	Yes
Health Savings Account (HSA)	No	No

Mandated Coverage of Adult Children. The new guidance confirms and clarifies the original mandate provided for under the Health Care Reform Law. In particular, the guidance confirms that employer-sponsored group health plans that cover dependent children must extend that coverage to *any* child of a covered employee until the child turns age 26 and may not impose any other eligibility requirements. The guidance notes that coverage does not have to

be extended to a child's spouse or to grandchildren. It does not, however, provide a specific definition of "child," unlike the tax guidance described below. The mandate applies for plan years beginning on or after September 23, 2010, and applies equally to fully-insured and self-funded plans.

Drinker Biddle Note: Examples of eligibility requirements that are not permitted under the Health Care Reform Law include marital status, student status, residency, financial support, tax dependent status, employment (or lack thereof) and eligibility for other coverage (or lack thereof). The new guidance makes it clear that the Health Care Reform Law does not distinguish between minor and adult children in this regard and, as a result, these restrictions should not be imposed on minor children either. Keep in mind that "grandfathered" plans are not required to provide an adult child coverage if the child has access to other employer-sponsored group health plan coverage (disregarding coverage provided through a parent) until January 1, 2014.

The new mandate applies to *all* adult children under the age 26 limit, regardless of whether enrolled in the plan (*i.e.*, it is not necessary that the child previously "aged out" of the plan or be currently covered by the plan).

Drinker Biddle Note: Any child currently on COBRA as a result of having aged out will need to be offered coverage under the expanded eligibility terms and, as a result, will experience a new qualifying event when the child later loses coverage as a result of reaching age 26.

Uniformity of Terms, Regardless of Age. Under the new guidance, the terms of the coverage provided to an adult child may not vary based on the age of a child (except with respect to children who are age 26 or older). In particular, examples in the new guidance make it clear that imposing an additional surcharge for an adult child, when no similar surcharge is imposed for covering a minor child, is prohibited. Similarly, all benefit options available to a minor child must be made available to the adult child.

Drinker Biddle Note: Many plan sponsors provide different cost "tiers," based on the number of individuals enrolled (e.g., employee only, employee plus one, family). While generally this practice may continue, plans may not have different tiers with distinctions based on age (except for individuals age 26 or older).

Transition Rule: Special Enrollment. To ensure that all eligible adult children have the opportunity to get the coverage mandated, the new guidance requires group health plans to provide each eligible adult child with a special enrollment opportunity of at least 30 days. The enrollment opportunity must begin no later than

the first day of the first plan year beginning on or after September 23, 2010, and any coverage elected must be provided effective as of the first day of that plan year (*i.e.*, for a calendar year plan, January 1, 2011, for coverage effective January 1, 2011). Like the existing HIPAA special enrollment rights, the plan must allow the parent to enroll if not already enrolled, and must allow the parent to elect a change in benefit package options (e.g., from PPO to HMO).

Drinker Biddle Note: Employers may find it helpful to coordinate this special enrollment period with their regular annual open enrollment period, but should be careful to clearly communicate the extent to which the annual open enrollment period may end earlier than the 30-day adult child special enrollment period.

The plan must provide written notice of the special enrollment opportunity; notification to an employee on behalf of the employee's child is sufficient for this purpose. The notice may be provided with other enrollment materials, provided the statement about special enrollment for adult children is prominent.

Drinker Biddle Note: Although the written notice is not required to be provided to an adult child who has not lost coverage as a result of age, as a practical matter it may be difficult (if not impossible) to identify which employees may have eligible adult children and then "weed out" those already covered. Accordingly, distribution of the notice to all eligible employees may be appropriate.

Early Implementation of Mandate. The new mandate applies to plan years beginning on or after September 23, 2010 (in the case of a calendar year plan, this means January 1, 2011). President Obama's administration is encouraging insurance companies to implement the new adult child coverage mandate early, however. A list of insurers who have agreed to voluntarily implement this provision early is available at: www.dol.gov/ebsa/newsroom/fsdependentcoverage.html?PrinterFriendly=true&. Many group health plan sponsors are considering early implementation as well.

Drinker Biddle Note: The new guidance states that it is anticipated that future guidance will make it clear that a grandfathered plan can voluntarily implement the mandate early without destroying grandfathered status for other purposes. This is welcome news for those employers interested in early implementation.

Tax Treatment of Coverage for Adult Children. The Health Care Reform Law, as clarified by the recent guidance, provides that the favorable tax treatment available for medical care provided to an employee's

child under an employer-sponsored group health plan will generally be available when that coverage is provided to an adult child who has not turned age 27 by the end of the taxable year. In other words, an adult child does not need to satisfy any specific dependency requirements (e.g., financial dependency, residency, unmarried, etc.) in order for the coverage provided and the benefits received to be excluded from the employee's gross income. The new tax treatment for coverage of a child extends only to an employee's child, stepchild, legally-adopted child or eligible foster child.

Drinker Biddle Note: Prior to the Health Care Reform Law, tax-favored coverage was not available unless the covered child met numerous dependency requirements (e.g., the child had to be under age 19 (age 24, if a full-time student), or be totally and permanently disabled). If the covered child did not meet these requirements, the fair market value of any coverage provided by the employer on the child's behalf was taxable to the employee as "imputed" ordinary income. As a result of the new Health Care Reform Law, this imputed income issue disappears for an adult child for any year in which the child is not yet age 27. The more complex tax dependency requirements, however, still apply for any individuals who are covered by a plan and are not the spouse or child (up to age 27) of the employee (e.g., if a more stringent state insurance law requires coverage beyond what the Health Care Reform Law mandates). Imputed income requirements will still apply in certain situations (e.g., for domestic partners and their children, to the extent the domestic partner or the domestic partner's children would not qualify as the employee's tax dependents for health coverage purposes). Note that state tax laws do not necessarily follow federal tax law and unless and until they do, employers may need to continue to impute income for purposes of state and local taxes.

This favorable tax treatment applies to any group health plan described in Code Section 105(b), which would include Health FSAs, stand-alone dental and vision plans, and health reimbursement accounts. It also applies to "VEBAs" and "401(h) accounts," and the deductions applicable to self-employed individuals under Code Section 162(l).

The new IRS guidance makes it clear that the favorable tax treatment only extends to children who have not reached age 27 at any time during the "taxable" year,

which means the employee's taxable year. Employers can assume that the employee's "taxable year" is the calendar year. In addition, employers can rely on the employee's representation as to the child's age.

Drinker Biddle Note: The general mandate to provide adult child coverage applies to children under the age of 26. In contrast, the favorable tax treatment applies to children under the age of 27 (as of December 31). This was done to ensure that income exclusion would continue to apply through the end of the year in which a child reaches 26 if the employer voluntarily provides coverage during that year after the child's 26th birthday.

The favorable tax treatment applies immediately as of March 30, 2010. The IRS guidance clarifies that FICA, FUTA and income tax withholding is not required with respect to the coverage of adult children under an employer-sponsored group health plan, without regard to their age, residency, support or other criteria.

Drinker Biddle Note: An employer that was imputing income to an employee for coverage of the employee's children, stepchildren, adopted children or eligible foster children who were not his or her tax dependents for health coverage purposes should stop doing so, beginning March 30, 2010. Conversely, income must continue to be imputed for periods before March 30, 2010. For other eligible children (e.g., a child of a domestic partner) who are not an employee's tax dependents for health coverage purposes, the employer should continue to impute income to the employee.

Cafeteria Plan Implications. In the case of a cafeteria plan or Health FSA, pre-tax salary reduction contributions may be made on behalf of adult children (who satisfy the age restrictions described above) as of any date on or after March 30, 2010. This facilitates early implementation of the adult child coverage mandate. A retroactive plan amendment reflecting this provision must be adopted, however, by December 31, 2010.

Drinker Biddle Note: The new guidance indicates that future guidance will be issued clarifying the extent to which the mid-year election change rules will be broadened to account for the changes made by the Health Care Reform Law.

Employee Benefits & Executive Compensation Practice Group

If you would like assistance in determining how the adult child mandate impacts your group health plan, including whether early implementation is appropriate for your organization, please contact a member of the Drinker Biddle Employee Benefits and Executive Compensation Team:

Kathleen O'Connor Adams
(312) 569-1306
Kathleen.Adams@dbr.com

Gary D. Ammon
(215) 988-2981
Gary.Ammon@dbr.com

Mark M. Brown
(215) 988-2768
Mark.Brown@dbr.com

Barbara A. Cronin
(312) 569-1297
Barbara.Cronin@dbr.com

Mona Ghude
(215) 988-1165
Mona.Ghude@dbr.com

Megan Glunz Horton
(312) 569-1322
Megan.Horton@dbr.com

Sharon L. Klingelsmith
(215) 988-2661
Sharon.Klingelsmith@dbr.com

Christine M. Kong
(212) 248-3152
Christine.Kong@dbr.com

David Levin
(202) 230-5181
David.Levin@dbr.com

Howard J. Levine
(312) 569-1304
Howard.Levine@dbr.com

Benjamin S. Lupin
(215) 988-2905
Benjamin.Lupin@dbr.com

Joyce L. Meyer
(312) 569-1305
Joyce.Meyer@dbr.com

Sarah Bassler Millar
(312) 569-1295
Sarah.Millar@dbr.com

Joan M. Neri
(973) 549-7393
Joan.Neri@dbr.com

Monica A. Novak
(312) 569-1298
Monica.Novak@dbr.com

Cristin M. Obsitnik
(312) 569-1303
Cristin.Obsitnik@dbr.com

Jean D. Renshaw
(610) 993-2259
Jean.Renshaw@dbr.com

Michael D. Rosenbaum
(312) 569-1308
Michael.Rosenbaum@dbr.com

Dawn E. Sellstrom
(312) 569-1324
Dawn.Sellstrom@dbr.com

Lori L. Shannon
(312) 569-1311
Lori.Shannon@dbr.com

Mark J. Simons
(610) 993-2247
Mark.Simons@dbr.com

Joshua J. Waldbeser
(312) 569-1317
Joshua.Waldbeser@dbr.com

Holly C. Kopack Willobee
(312) 569-1312
Holly.Willobee@dbr.com

David L. Wolfe
(312) 569-1313
David.Wolfe@dbr.com

Daniel R. Zoller
(312) 569-1307
Daniel.Zoller@dbr.com

Drinker Biddle

Employee Benefits & Executive Compensation Practice Group

www.drinkerbiddle.com

CALIFORNIA | DELAWARE | ILLINOIS | NEW JERSEY | NEW YORK | PENNSYLVANIA | WASHINGTON DC | WISCONSIN

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One Logan Square, Ste. 2000 | Philadelphia, PA 19103-6996 | (215) 988-2700 | (215) 988-2757 fax
Jonathan I. Epstein and Edward A. Gramigna, Jr., partners in charge of the Princeton and Florham Park, N.J., offices, respectively.

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