Adult Child Coverage Extension and Related Tax Treatment

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Seth Perretta
Adult Child Extended Coverage

- Act requires a plan to provide adult child coverage if it provides for any dependent coverage
  - Effective for plan years beginning on or after September 23, 2010 (i.e., 2011 for calendar year plans) REGARDLESS OF PLAN’S GRANDFATHERED STATUS
  - For plan years beginning prior to 2014, a “grandfathered” group health plan must only provide adult child coverage to qualifying individuals who are not offered other qualifying employer-sponsored coverage
    - When is the adult child disqualified from coverage?
      - Informal guidance from the Committees on Ways & Means, Energy & Commerce and Ed & Labor, dated April 2, 2010, appears to clarify that a qualifying individual cannot be denied extended coverage just because he or she may be eligible for coverage under other employer-sponsored coverage available to him or her through a third party or family member (e.g., parent or sibling) (http://docs.house.gov/energycommerce/TIMELINE.pdf)
    - Coordination of benefit issues
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Who qualifies?

- Statute refers to adult children under the age of 26
  - Statute does not expressly incorporate tax dependent definition or related tests
  - Statute says HHS Secretary shall issue regulations defining those “dependents” that are eligible
    - COMING SOON!! – OMB just received interim final rule from HHS
    - IRS Notice 2010-38 does not incorporate support or income tests, though not determinative here

- Is there an “age-in” requirement?
  - Answer: Appears to be “no”, but we’ll have to wait and see
Q: What types of coverage are subject to the coverage extension?
A: Generally all group health plan coverage, unless HIPAA-excepted.

**IN**
- Major Medical
- HRA
- Mini-Medical

**OUT**
- HIPAA-Excepted
  - Health FSA
  - HSA
  - Dental
  - Vision
  - LTC
  - Specified Disease
  - Fixed/Hospital Indemnity
  - Med Supplemental
  - Disability
  - Onsite Medical
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Does your plan currently provide dependent coverage?

NO

** Sponsor’s Choice **
May offer adult child coverage at plan sponsor’s election

YES

Must provide adult child coverage generally beginning for plan years after 9/22/10 (i.e., for 2011 for calendar year plans)
Adult Child Extended Coverage

- Corresponding tax change made by reconciliation bill

  - Makes employer-paid coverage (directly or via cafeteria plan) for an adult child tax-free (i.e., excludable from income) for any tax year ending prior to the year in which such child attains age 27
    - Whether paid for directly by the employer (i.e., via a subsidy) or paid by the employee through a cafeteria plan

  - Why the disconnect between the coverage and tax provision?
    - Employers with calendar year plans will not need to dis-enroll adult children mid-year when they turn age 26

**Recent IRS guidance – Notice 2010-38**
Recent IRS Notice 2010-38 provides important guidance

- Makes clear dependency tests **DO NOT** apply for purposes of determining whether an adult child qualifies for tax-free employer-provided coverage
  - NOT determinative for how HHS will proceed, but certainly suggestive
Recent IRS Notice 2010-38 Provides Important Guidance (Cont’d)

- Employers may rely on employees’ representations regarding children’s ages
  - Not clear whether such representations need to be in writing
- Effective March 30th, coverage and benefits are tax-free if employer-paid
  - Treasury regulations forthcoming
- Allows for mid-year election changes regarding coverage on or after March 30th
  - Treasury regulations forthcoming
- Provides transition rule for 2010 cafeteria plan amendments
  - Plan sponsors have until December 31st to amend plans
- Clarifies that employer-paid adult child coverage is excepted from wages for payroll tax purposes
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- What employer-provided adult child coverage is eligible for tax-free treatment?

**IN**

All IRC § 105(b) health plans, including:
- Major Medical
- Dental
- Vision
- HRA
- Health FSA
- Specified Disease
- Med Supplemental
- Onsite Medical
- Mini Medical

**OUT**

- Everything else not qualifying as IRC § 105(b) health plans, including:
  - Life
  - Disability
  - AD&D
  - HSA (but not underlying HDHP coverage)
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2010 Transition Year Issue

OPTION 1 – Status Quo
- **PRO**: Easy to administer
- **PRO**: To extent self-insured, increased premiums for plan sponsor
- **CON**: Increased employee premium cost in form of COBRA premiums for adult child
- **CON**: No employee relations “bump”

OPTION 2 – Status Quo with Pre-Taxing of COBRA Coverage Through Cafeteria Plan
- **PRO/CON**: Same as Option 1 except that employee’s premium cost for adult child COBRA coverage is reduced to extent of marginal tax rate; also some marginal employee relation’s “bump”

OPTION 3 – Extend Coverage to Adult Children Who Would Otherwise Lose Coverage
- **PRO**: Good for employee relations
- **PRO**: Reduces disruption in coverage
- **CON**: Likely need to amend health plan and cafeteria plan documents
- **CON**: For employer, increases cost because lose COBRA premiums, unless increase premium cost for adult child coverage during transition period

OPTION 4 – Extend Coverage to All Qualifying Adult Children Regardless of Whether Enrolled Now
- **PRO**: Good for employee relations (arguably even better than Option 3)
- **PRO**: Reduces disruption in coverage
- **CON**: Likely need to amend health plan and cafeteria plan documents
- **CON**: For employer, increases cost because lose COBRA premiums, unless increase premium cost for adult child coverage during transition period
- **CON**: Possible adverse selection
Wrap-Up

Questions?

Contact Information

Seth Perretta
Partner, Davis & Harman LLP
(202) 347-2230
www.davis-harman.com