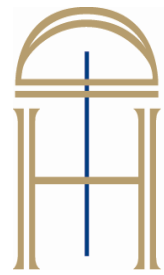


**American Benefits Council
Initial Agency Guidance on PPACA**

**Adult Child Coverage Extension
and Related Tax Treatment**

May 6, 2010

Seth Perretta



**DAVIS &
HARMAN_{LLP}**

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



Adult Child Extended Coverage



➤ 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

Adult Child Extended Coverage

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

Adult Child Extended Coverage



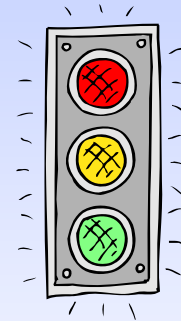
Does your plan currently provide dependent coverage?

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

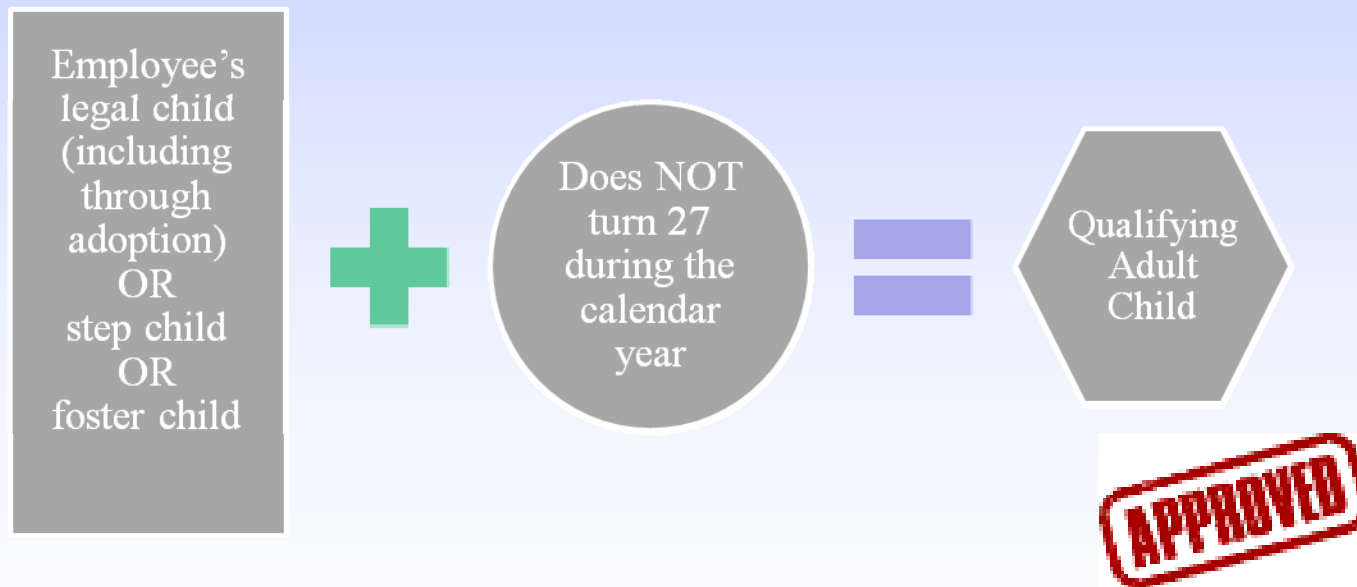


- Makes employer-paid coverage (directly or via cafeteria plan) for an adult child tax-free (i.e., excludable from income) for any tax year ending prior to the year in which such child attains age 27
 - Whether paid for directly by the employer (i.e., via a subsidy) or paid by the employee through a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

Adult Child Extended Coverage

- 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



Adult Child Extended Coverage

- 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

Adult Child Extended Coverage

- 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)



Adult Child Extended Coverage

➤ 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

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