Fixing the "Glitch" – The IRS Releases Final Rule Addressing the "Family Glitch"

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On Tuesday, October 11, Treasury and IRS issued final regulations amending the regulations under the Affordable Care Act ("ACA") regarding the affordability determination for an employee's family members of employer-sponsored health coverage (the "2022 Regulations"). The 2022 regulations are effective beginning with the 2023 tax year. On October 11, the IRS also issued Notice 2022-41, which addresses the cafeteria plan change in election rules.

Individuals are generally ineligible for premium tax credits ("PTCs") to purchase subsidized health insurance on the Exchange if they receive an offer of affordable employer-sponsored coverage. Under the existing regulations from 2012 (the "2012 Regulations"), the affordability of employer-sponsored coverage for a family member is determined based on the affordability of self-only coverage, rather than the affordability of family coverage—this has come to be known as the "family glitch." The 2022 Regulations fix this "glitch" by basing the affordability of employer-sponsored coverage for a family member on the cost of family coverage, rather than self-only coverage.

Background

Code section 36B defines an affordable plan for PTC purposes as a plan with the employee's required contribution that is less than 9.5% of household income (indexed; this percentage will be 9.12% in 2023). Code section 36B cross-references part of the individual mandate provision in Code section 5000A, stating that an employee's required contribution for coverage is determined by the cost of self-only coverage. In the 2012 Regulations, the IRS used this cross-reference to determine that affordability of coverage for both employees and their family members should be determined based on the cost of self-only coverage. However, as many commenters to the 2012 Regulations pointed out, Code section 5000A also includes a provision for individuals related to employees indicating that their affordability standard should be determined by the employer's required contribution for family coverage, not self-only coverage. Nevertheless, the IRS finalized the 2012 Regulations as originally proposed, rendering family members ineligible for PTCs where the self-only coverage is affordable, regardless of the cost of family coverage.

In January 2021, President Biden issued Executive Order 14009, "Strengthening Medicaid and the Affordable Care Act," which directed the Secretary of Treasury to reconsider previous regulations that limit access to affordable coverage. This was generally interpreted as opening the door to reconsideration of the "family glitch."

On April 5, 2022, Treasury and IRS issued proposed regulations, followed by a 60-day comment period and a public hearing held in June. The preamble to the 2022 Regulations states that the IRS received 3,888 comments, "the overwhelming majority of which were in support" of revising the rule.

Impact on Insurance Markets

The Treasury Department's Office of Tax Analysis estimates that this regulatory change will likely result in about one million new enrollees in PTC-subsidized Exchange coverage. The reason for the estimate of just one million new subsidized enrollees compared to the more than five million people estimated to fall in the family glitch is likely because many families will choose to keep all family members in one employer-based plan, rather than split the family between two plans.

GROOM INSIGHT: The affordability standard for an employee's PTC eligibility remains based on the cost of self-only coverage, so this regulatory change will not increase the number of employees who will newly become eligible for PTC-subsidized coverage on the Exchange.

The preamble to the 2022 Regulations notes that HHS has informed Treasury and the IRS that HHS will update the Exchange application in advance of the 2023 Open Enrollment season.

Impact on Employers

The preamble states that Treasury and IRS do not expect the revised rule to have a meaningful impact on the cost of employer-sponsored coverage, but they do expect that the aggregate amount that employers spend on coverage will decrease slightly because some enrollees will move from employer-sponsored coverage to Exchange coverage.

GROOM INSIGHT: The 2022 Regulations do not affect the employer mandate penalty, because they do not change the affordability rules for employees themselves, and the employer mandate is only triggered when an employee, not a family member, receives a PTC. Therefore, when a family member purchases health insurance on the Exchange, the employer is not penalized for failure to offer affordable coverage.

Alongside the 2022 Regulations, the IRS issued Notice 2022-41 regarding the cafeteria plan change in election rules. Under current cafeteria plan rules, employees cannot change their election for family coverage mid-plan year unless they have experienced a permitted change in election event. Under the Notice, an employer with a non-calendar year plan can permit employees to drop family coverage under employer-provided minimum essential coverage mid-plan year if:

- one or more of the family members are eligible for a special enrollment period to enroll in coverage through the Exchange or seeks to enroll during the Exchange's annual open enrollment period; and
- the revocation of coverage corresponds to the intended enrollment of the family member in coverage through the Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the revoked coverage.

GROOM INSIGHT: If the employee does not enroll in the Exchange coverage, the employee must elect self-only coverage (or family coverage with the already-covered family members who are not enrolling in Exchange coverage) under the employer's plan.

An employer that wants to adopt this provision and permit employees to cancel family coverage mid-year must amend its cafeteria plan on or before the last day of the plan year in which the election changes are allowed, and the amendment may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the guidance under the Notice and the employer informs participants of the amendment. For the 2023 plan year, an employer can amend its cafeteria plan at any time on or before the last day of the 2024 plan year. An employer may not, however, allow employees to revoke coverage on a retroactive basis.

If you have any questions regarding these new regulations addressing the "family glitch" and their implications and best practices for insurers and employers, please contact the authors of this alert or any of our Groom attorneys.