

Authors: Sravya Boppana, Christine L. Keller, William F. Sweetnam, Jr., Brigen L. Winters
If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Kathryn Bjornstad Amin
kamin@groom.com
(202) 861-2604

Sravya Boppana
sboppana@groom.com
(202) 861-6338

Jon W. Breyfogle
jbreyfogle@groom.com
(202) 861-6641

Lisa A. Christensen
lchristensen@groom.com
(202) 861-0176

Thomas F. Fitzgerald
tfitzgerald@groom.com
(202) 861-6617

Kelly A. Geloneck
kgeloneck@groom.com
(202) 861-5418

Katy S. Kamen
kkamen@groom.com
(202) 861-6646

Christine L. Keller
ckeller@groom.com
(202) 861-9371

Tamara S. Killion
tkillion@groom.com
(202) 861-6328

Emily C. Lechner
elechner@groom.com
(202) 861-9386

Mark C. Nielsen
mnielsen@groom.com
(202) 861-5429

Seth P. Perretta
sperretta@groom.com
(202) 861-6335

Malcolm C. Slee
mslee@groom.com
(202) 861-6337

Ryan C. Temme
rtemme@groom.com
(202) 861-6659

Christy A. Tinnes
ctinnes@groom.com
(202) 861-6603

Vivian Hunter Turner
vturner@groom.com
(202) 861-6324

Allison Ullman
aullman@groom.com
(202) 861-6336

Will E. Wilder
wwilder@groom.com
(202) 861-6640

William F. Sweetnam, Jr.
wsweetnam@groom.com
(202) 861-5427

Brigen L. Winters
bwinters@groom.com
(202) 861-6618

IRS Modifies Cafeteria Plan Rules to Allow Certain Employees to Drop Employer-Provided Group Health Plan Coverage

The Internal Revenue Service (“IRS”) released new rules allowing an employer to adopt a cafeteria plan provision under which an employee can revoke his/her election to pay for group health plan coverage upon a reduction in hours and purchase of other health coverage or to purchase health insurance through a state or federal Exchange.

Background

Under current IRS cafeteria plan regulations, an employee must make an advance election to reduce a portion of his or her salary that will be used on a pre-pay basis for health insurance premiums and other medical expenses. The election must be irrevocable during the year except to the extent that there has been a change in status of the employee during the year. Under the regulations, changes in status that could lead to a permissible change in the cafeteria plan election include a change in marital status, or a change in number of dependents. In addition, under current regulations, a change in employment status can only lead to a permissible change in the cafeteria plan election if it results in a change in plan eligibility. This could be problematic in certain instances. For example, if an employer is subject to the employer mandate and uses a look-back measurement method, an individual could be locked into his election for the duration of his stability period even if he has a reduction in hours. Additional information on the employer mandate is available at: <http://www.groom.com/resources-867.html>.

Under the Affordable Care Act (“ACA”), individuals can purchase health insurance coverage through a state or federally-run Exchanges. Low and moderate-income individuals may be eligible for tax credits and other subsidies for insurance purchased through an Exchange if the individual is not eligible for minimum essential coverage from his or her employer or if the coverage is unaffordable or it does not provide minimum value. These subsidies can be very helpful in making insurance coverage affordable for low and moderate income individuals. Individuals who elect to make salary reduction contributions to a cafeteria plan are not eligible to purchase insurance under an Exchange and receive the subsidies, and the IRS regulations may make it difficult for an employee to change that election. It is important to note that an individual cannot use a cafeteria plan to purchase health coverage under an Exchange (except through the SHOP Exchange).

Modification of the Cafeteria Plan Change in Status Rules

On September 18, 2014, the IRS released Notice 2014-55 which expanded the current rules on when an employee can modify or revoke the election to contribute to a cafeteria plan for

group health plan coverage. The Notice stated that the cafeteria plan regulations will be modified to provide two additional situations where an employee could revoke his or her cafeteria plan election for group health plan coverage to allow the employee to be able to receive subsidized health care coverage under an Exchange. These two situations are:

- An employee's employment status has changed so that the employee is reasonably expected to work less than 30 hours per week (meaning that the employee is not a full-time employee under the ACA), even if the reduction does not result in the employee ceasing to be eligible for coverage under the employer's group health plan. The revocation of the election must correspond with the intended enrollment in other health coverage that is minimum essential coverage¹ and the plan may rely on reasonable representations of the employee to that fact.
- An employee would like to cease coverage under the employer's group health plan and purchase coverage through an Exchange. This revocation will be allowed as long as the employee is eligible to enroll in coverage through an Exchange during a special enrollment period or during the Exchange's annual open enrollment period. This new coverage must be effective immediately after the day the original coverage was revoked. The employer may rely on the reasonable representations of the employees of these facts.

This modification of the irrevocable election rules provided by the Notice does not apply to cafeteria plan elections to contribute to a flexible spending arrangement. One thing to note is that the Notice applies to cafeteria plan elections to contribute to group health plans that provide minimum essential coverage. This means that cafeteria plan elections for stand-alone dental and vision plans or critical illness plans (which are excepted benefits and do not provide minimum essential coverage) cannot be changed based on this guidance.

Actions Required of Employers

The IRS stated that these changes would be effective immediately. However, employers do not have to provide employees this opportunity to change their cafeteria plan elections during the year. If the employer does want to give employees the ability to change cafeteria plan elections, the IRS reminded employers that their cafeteria plan document must be amended in order to provide these mid-year election changes. The amendment must be adopted on or before the last day of the plan year in which the election changes are allowed; however, these election changes are permitted in the 2014 plan year as long as the amendment is made by the end of the 2015 plan year. Although the amendment can be made retroactively, if it is retroactive, (1) the employer must notify participants of their ability to revoke their election, and (2) the cafeteria plan must comply with the guidance from the date the election changes are permitted. Further, the IRS stated that in no event is a retroactive revocation of a cafeteria plan election permitted.

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¹ The definition of "minimum essential health coverage" under section 5000A(f) of the Code is very broad and includes government-sponsored programs, employer-sponsored plans, and plans in the individual market. The definition does not include "excepted benefits," however, such as stand-alone dental, vision or critical illness plans.