

IRS Expands Permissible Cafeteria Plan Election Changes

The IRS has released guidance expanding the cafeteria plan election change rules to accommodate two ACA-related events. The guidance addresses two “election-lock” situations, permitting election changes when an employee experiences a reduction in hours during a shared responsibility stability period and for special or open enrollment periods in the public marketplace. Employers will need to determine whether to expand the list of permissible election change events under the terms of their cafeteria plan.

Background

A “cafeteria plan” is a plan under which an employee may choose among two or more benefits consisting of cash and qualified benefits, and to pay for certain benefits on a pre-tax basis. “Qualified benefits” are specific employee benefits (e.g., health coverage and dependent care assistance) that are excludable from taxable income under the Internal Revenue Code. Generally, elections made under a cafeteria plan must be irrevocable for the entire plan year. However, a cafeteria plan can permit employees who experience certain events during the plan year to make mid-year election changes for health coverage as long as the election change satisfies the consistency requirements under the regulations. One permitted circumstance is when an employee (or other individuals covered by the plan by virtue of their relationship to the employee) experiences a “change in employment status,” like switching from full- to part-time, that affects the eligibility for coverage under a group health plan. Additionally, under the rules, the election change must correspond with the event and only those individuals affected by the event can revoke or decrease health coverage under the cafeteria plan (and they must take the coverage for which they are newly eligible).



To accommodate coverage in the ACA’s marketplace (also known as the exchange), HHS rules provide for open enrollment periods, which for 2015 run from November 15, 2014 through February 15, 2015, and special enrollment rights that allow individuals to enroll in coverage outside of the open enrollment period. The special enrollment rules permit enrollment in a marketplace plan or a change from one marketplace plan to another following certain qualifying events like losing minimum essential coverage, gaining a dependent, becoming a US citizen or national,

or moving permanent residences. (See our [August 4, 2014 For Your Information.](#)) While the cafeteria plan rules permit election changes that correspond with HIPAA special enrollment rights, such as a loss of health coverage, marriage, or birth/adoption of a child, the current rules do not permit a change of election that corresponds with these marketplace special enrollment rights.

Notice Permits Additional ACA-Related Election Changes

The IRS issued [Notice 2014-55](#) to respond to these ACA-related events that do not specifically have an effect on the employee's (or related individuals') eligibility for health coverage under an employer's plan. The guidance expands permissible cafeteria plan election changes to include an employee's reduction in hours during a shared responsibility stability period (when eligibility for coverage otherwise is not affected) and special and open enrollment periods in the public marketplace (when eligibility for marketplace coverage is gained, but coverage under the employer's plan is not affected). Note this guidance impacts health coverage other than a health FSA. It is not applicable to a health FSA election.

Reduction in Hours

Under the new guidance, a full-time employee (i.e., one who is expected to average at least 30 hours of service per week) can drop group health plan coverage mid-year if the employee experiences the status change event of reducing hours to part-time (e.g., is expected to average less than 30 hours of service per week), even if the reduction of hours, for example because of a stability period, does not result in a loss of eligibility for health coverage.

Comment. Among other things, this guidance should provide some relief to both employees and employers. Employees reducing hours and switching to part-time employment status will no longer experience "election lock" during a shared responsibility measurement period. Concurrently, employers may not be exposed to a shared responsibility (section 4980H) assessment if the part-time employee voluntarily drops the coverage during a stability period.

The change must correspond with the intended enrollment of the employee (and any related individuals whose coverage is being dropped) in other minimum essential coverage. The new coverage must be effective no later than the first day of the second month following the month in which the original coverage is dropped. The plan can rely on an employee's reasonable representation about the intended enrollment.

Comment. Note that while this guidance helps the "election lock" situation involving a measurement/stability period, its application is broader. For example, regardless of the effect on eligibility for coverage under the employer's cafeteria plan, an employee who experiences a reduction in hours from full- to part-time can be permitted to drop his or her election under the cafeteria plan and enroll in the spouse's employer's plan (presuming the spouse's employer allows a corresponding change).

Seeking Marketplace Coverage

An employee who is eligible to enroll in marketplace coverage (either during an special or open enrollment period) can drop group health plan coverage mid-year, but only if the affected individual correspondingly enrolls in marketplace coverage that is effective no later than the day after the last day of the original coverage. The individual must express his or her intent to enroll in marketplace coverage, and the cafeteria plans can rely on the employee's reasonable representation of that intention.

Comment. This guidance allows employees participating in non-calendar-year plans to elect marketplace coverage during the marketplace open enrollment period and drop the employer-provided coverage when the marketplace coverage takes effect. Additionally, in some circumstances, this provision might aid employees participating in a calendar year plan who seek marketplace coverage during January through February 15.

Effective Date and Plan Amendments

The IRS intends to amend the election change regulations, but, employers can rely on this guidance immediately. A cafeteria plan will need to be amended to accommodate these additional election changes. The amendment generally must be adopted on or before the last day of the plan year in which the new election change events are allowed and can be effective retroactively to the first day of that plan year, provided that the plan operates in accordance with the guidance and that participants are informed of the amendment. Under a special rule, employers that allow these changes during the 2014 plan year have until the last day of the 2015 plan year to adopt an amendment. Although plan amendments may be adopted retroactively, election changes to revoke coverage retroactively are not permitted.

Comment. Employers should also keep in mind that any expansion of permitted election changes should be prospectively and timely communicated so that employees understand their options under the cafeteria plan. Any changes will also require coordination with TPAs or other service providers.

Guidance Effective Date

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In Closing

This guidance is welcome news for employers. It addresses two important situations that appeared to have locked employees into their health coverage elections. Since 2010, cafeteria plans and the underlying benefits have been subject to a number of changes (e.g., the health FSA salary reduction limit of \$2,500, the carryover of \$500 from one plan year to another, and various election change events (CHIPRA, adult children), and now this most recent guidance). The IRS has indicated each time through guidance that changes to the cafeteria plan regulations would be forthcoming. Most recently, IRS officials have informally indicated that they might re-propose the cafeteria plan regulations in their entirety, rather than issue piecemeal guidance. But for now, employers can rely on this most recent guidance immediately.

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