
Health Care Benefits Update: Amending Plans for Adult Children; New COBRA Notices

by Mark C. Jones

Several sets of health care guidance have recently been issued that require prompt employer action. Interim final rules were published today under the health care reform bill requiring employers that maintain group health plans covering children of participants to extend coverage to adult children. The IRS has issued companion guidance that permits employers to offer tax-exempt coverage of adult children retroactively to March 30, 2010, under their health plans, including cafeteria plans, provided the cafeteria plans are amended by the end of this year. The Department of Labor is also requiring employers to amend and distribute COBRA notices to employees and covered family members affected by the most recent extension of the COBRA subsidy period.

Mandatory Coverage of Adult Children

The Patient Protection and Affordable Care Act (the “Affordable Care Act”), as discussed in our client alert dated [March 30, 2010](#), requires all insured group health plans and self-insured plans that offer coverage to participants’ children to include any children who are under age 26 and would be treated as dependents under the plan but for their age. This change is effective for plan years beginning on or after September 23, 2010. Plans in existence on March 23, 2010, however, may wait until the 2014 plan year to extend coverage to adult children who are eligible to enroll in another employer-sponsored health plan.

This morning, the U.S. Departments of Treasury, Labor, and Health and Human Services published interim final rules under the Affordable Care Act requiring plan sponsors to implement this change by amending their plans to re-define the term “dependent,” for purposes of eligibility of children, solely in terms of the relationship between the child and the participant. Therefore, employers must remove from their plan documents, including summary plan descriptions and enrollment materials, any other eligibility requirements such as financial dependency, student status or shared residence. The preamble to the interim rules states that amendments to plan terms made to comply with the requirement to extend coverage to adult children,

including voluntary compliance before the September 23, 2010 effective date, should not cause a plan in existence on March 23, 2010 to lose its grandfathered status for any purpose under the Affordable Care Act.

In broadening the definition of “dependent,” employers may not vary the terms of coverage of children based on age. For example, employers may not impose an additional surcharge for the coverage of adult children or restrict the benefit available to adult children in a way that does not apply to children generally.

The interim final rules also require employers to revise their plan materials to offer a special enrollment period of at least 30 days, beginning no later than January 1, 2011, for calendar-year plans, for any children whose coverage ended or who were previously ineligible for coverage, including any such children receiving continuation health care (“COBRA”), because the plan imposed an age limit below age 26. These children must be offered the same benefits at the same cost offered to similarly situated individuals who retained coverage. Employers must also provide written notice, either as part of the plan’s enrollment materials or separately, to all such children (or their eligible parents), informing them of their eligibility for coverage and the new enrollment period.

Tax Exemption for Coverage of Adult Children

In a companion piece of legislation to the mandatory coverage rules, the Health Care and Education Affordability Reconciliation Act of 2010 (the “Reconciliation Act”) expanded the exclusion from gross income under Section 105(b) of the Internal Revenue Code (the “Code”) for payments received under an employer-provided health plan for adult children (including children who are not “dependents” of the employee under Section 152 of the Code) through the end of the year in which they turn 26, effective as of March 30, 2010. The Reconciliation Act did not amend Section 106 of the Code, which excludes employer-provided health plan coverage from an employee’s gross income, but on April 27, 2010, the Internal Revenue Service (the “IRS”) released Notice 2010-38, which states that the agency intends to adopt regulations under Section 106 that relieve employees from having the value of employer-provided coverage for adult children imputed to them.

Notice 2010-38 also clarified that employee health plan contributions for qualifying adult child coverage will be tax-exempt, including contributions to a health reimbursement account or a cafeteria plan (including a health flexible spending account). Generally, these plans will need to be amended by the end of the year to take advantage of this exclusion, and the IRS has created specific transitional relief allowing cafeteria plans to be amended retroactive to March 30, 2010, to cover qualifying adult children if the employer adopts the amendments by December 31, 2010. For most plans, adopting these amendments in 2010 is voluntary. As discussed above, single-employer, calendar-year health plans are not required to cover adult children until 2011.

The IRS also intends to modify cafeteria plan regulations under Section 125 of the Code to permit mid-year changes in election in the event an adult child incurs a “change in status,” such as becoming newly eligible for coverage or becoming eligible for coverage beyond the date on which the adult child would otherwise have lost coverage. Doing so would allow employees who participate in cafeteria plans to make pre-tax contributions this year to cover expenses for their adult children, if the cafeteria plans are amended by the end of the year.

Employers do not need to verify the age of any child who is added as a beneficiary to a plan. They may rely on an employee’s representation of age for this purpose. Stepchildren, adopted children and qualifying foster children are considered “children” for all purposes of the exemption.

The IRS also clarified that the value of employer-provided coverage and payments from an employer health plan for adult children will not be subject to withholding taxes or treated as wages subject to employment taxes. In addition, the definition of “dependent” will be amended in applicable regulations so that the inclusion of adult children as beneficiaries under a health plan will not jeopardize the tax-exempt status of any VEBA or Section 401(h) account funding the plan.

Extension of COBRA Subsidy through May 31, 2010

On April 15, 2010, President Obama signed into law the Continuing Extension Act of 2010, extending by two months, through May 31, 2010, the eligibility period during which employees and their family members may receive a 65% subsidy toward premiums for federal COBRA coverage or coverage under comparable state laws, such as so-called “mini-COBRA” programs. Prior to this extension, COBRA premium subsidies were available only for employees whose employment ended prior to April 1, 2010. (The COBRA subsidy is discussed in our client alerts dated [February 24, 2009](#), [March 24, 2009](#) and [April 10, 2009](#).)

To be eligible to receive the COBRA premium subsidy, the employee must have had either (i) an involuntary termination, resulting in eligibility under federal COBRA or comparable state law, between September 1, 2008, and May 31, 2010, or (ii) a reduction in hours between September 1, 2008, and May 31, 2010, resulting in a loss of coverage, followed by an involuntary termination between March 2, 2010, and May 31, 2010. During the subsidy period, which runs for up to 15 months from the date on which the individual first becomes eligible for assistance, individuals who pay 35% of their COBRA premium are treated as having paid the full amount. The remaining 65% of the premium is reimbursable to the employer maintaining the plan as a credit against payroll taxes.

Plan administrators must provide a general COBRA notice that describes the extended subsidy period to any individual or covered family member of an individual who experienced any event that qualified them for COBRA coverage (including, but not limited to, termination of employment) during the period between September 1, 2008, and May 31, 2010. If any individual whose employment was terminated between March 1, 2010, and April 14, 2010, already received a general COBRA notice, then the plan administrator must provide the individual and his or her covered family members with a supplemental notice describing the extended subsidy period. The Department of Labor has posted model notices for this purpose on its website at <http://www.dol.gov/ebsa/COBRAModelNotice.html>, as well as special notices for individuals who lost coverage owing to a reduction in hours followed by a termination of employment, and for individuals covered by state laws comparable to COBRA.

In general, individuals have 60 days after loss of coverage to elect COBRA. However, if an individual's employment ended between April 1, 2010, and April 14, 2010, and the individual did not receive notice of the extended COBRA subsidy period, he or she will have 60 days after the date when the updated notice is provided to elect retroactive coverage. Therefore, plan administrators are advised to distribute the updated notices as soon as practicable.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or any of the members of the Executive Compensation & Benefits group.

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