

IRS Coordinates Cafeteria Plan Rules with the ACA: Two New Election Changes Allowed

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Existing cafeteria plan rules make it difficult (if not impossible) for participants to revoke pre-tax salary reduction elections mid-year and enroll in qualified health plan coverage through the Health Insurance Marketplace (the “Marketplace,” sometimes referred to as the “Exchange”).

To provide additional flexibility, the IRS issued Notice 2014-55, creating new opportunities for a participant to change mid-year an otherwise irrevocable cafeteria plan election. Under this guidance, a cafeteria plan may allow an employee to prospectively revoke an election of coverage under a group health plan that provides minimum essential coverage (MEC) when there is a:

- Reduction in hours of service of a full-time employee (FTE) that otherwise does not affect group health plan eligibility; or
- Marketplace special enrollment opportunity or the Marketplace annual enrollment period.

Employers may, but are not required to, adopt either (or both) of these new permitted election changes. Adopting these changes will require a plan amendment and notification to participants. If adopted, participants may elect to revoke health plan coverage on a prospective basis; retroactive revocation is not permitted.

Only elections for MEC (generally, group health plan coverage) may be revoked under these rules. Therefore, a participant may not revoke a pre-tax election for dental or vision coverage as such coverage is not MEC (generally considered excepted benefits). Also, changes to the health FSA election are not permitted.

This guidance is effective as of September 18, 2014 and may be relied upon. The IRS intends to amend existing regulations to reflect these changes.

Below you will find additional information regarding the new permitted election change provisions, as well as some important nuances that employers should be aware of when considering this option.

Revocation of a Pre-Tax Election Due to a Reduction in Hours of Service

Background

Under the employer mandate, beginning in 2015, applicable large employers (generally 50 or more FTEs) are subject to a penalty if the employer does not offer MEC to one or more FTEs and their dependents and the FTE receives a subsidy to purchase coverage in the Marketplace. FTE status is determined under one of the following methods: the monthly measurement method or the look-back measurement method.

Under the look-back measurement method, an employee is determined to be an FTE based on the hours of service during a measurement period. If identified as an FTE in the measurement period, the employee is treated as an FTE for the entire duration of a subsequent stability period (SP), regardless of what happens to the employee's hours during the SP (so long as s/he remains the employee of the employer). Under the look-back measurement method, an employee could have a change in employment status during the SP resulting in a reduction in hours (e.g., change from a full-time position to a part-time position). This reduction in the employee's hours does not affect the employee's status as an FTE for purposes of the employer penalty throughout the SP. To insulate from penalty exposure, some employers will offer coverage to employees for all periods during which they are classified as FTEs. Due to cafeteria plan regulations, there can be no loss of eligibility for coverage when hours are reduced because there is no change in status (e.g., a loss of eligibility due to a reduction in hours).

New Permitted Election Change

This guidance creates a new permitted election change so that a cafeteria plan may allow an employee to prospectively revoke an election of group health plan coverage that provides MEC (and is not a health FSA) due to a reduction in hours where eligibility for coverage is not lost, subject to the following conditions:

- The employee has been in an employment status under which the employee was reasonably expected to average at least 30 hours of service per week and there is a change in that employee's status so that the employee will reasonably be expected to average less than 30 hours of service per week after the change, even if that reduction does not result in the employee ceasing to be eligible under the group health plan; and

- The revocation of the election of group health plan coverage corresponds to the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in another plan that provides MEC (e.g., a qualified health plan or coverage under a spouse's group health plan), with the new coverage effective date no later than the first day of the second month following the month that includes the date the original group health plan coverage is revoked.

For this purpose, a cafeteria plan may rely on the employee's reasonable representation that the employee and related individuals have enrolled or intend to enroll in another plan that provides MEC for new coverage that is effective no later than the first day of the second month following the month that includes the date the original group health plan coverage is revoked.

If considering this election change, employers should be aware of the following:

- **Ability to access the Marketplace may be limited.** If the FTE who experiences a reduction in hours remains otherwise eligible for the group health plan, will the individual actually be able to enroll in Marketplace coverage as a result of that change? If the reduction in hours results in the participant becoming newly eligible for a subsidy in the Marketplace (due to lower pay), then he or she may be eligible for enrollment in Marketplace coverage. However, voluntarily ending coverage alone does not qualify an individual for special enrollment in the Marketplace. It is uncertain if Marketplace rules will be changed to match cafeteria plan provisions.

- **Ability to access other MEC may be limited.** An employee may revoke an election under this provision to enroll in any MEC, including coverage through a spouse's employer plan. However, the employee considering a revocation of coverage under this provision will need to determine whether "mid-year" enrollment is permissible under the other plan. Generally, group health plans are very limited as to when individuals may enroll outside of open enrollment.
- **Potential liability under the employer mandate.** If the coverage the FTE revokes due to the hours change is unaffordable or not minimum value, and the employee receives a subsidy to buy qualified health plan coverage in the Marketplace, the employer may be liable for a penalty assessment for each month during the SP where the employee receives the subsidy and is considered the FTE of the employer. This would not otherwise pose a problem because an individual is not eligible for a subsidy when he is enrolled in MEC, regardless of affordability or minimum value.

Further clarification on these points would be helpful.

Revocation due to Enrollment in Marketplace Coverage

Background

Under existing cafeteria plan rules, a participant may not revoke an election under a group health plan mid-year solely to enroll in a qualified health plan offered in the Marketplace. This is of particular concern for employees who are covered by a non calendar-year cafeteria plan because the Marketplace open enrollment period occurs at a specified time each year and does not permit the purchase of coverage that begins at the end of a non calendar-year plan (for 2015, the annual open enrollment period is November 15, 2014 – February 15, 2015). Thus, the employee covered under a non calendar-year plan who wants to enroll in Marketplace coverage during annual enrollment may not be able to synchronize the change in coverage without either having an overlapping period of coverage or a period without coverage.

In addition, while existing cafeteria plan rules allow election changes consistent with special enrollment rights under HIPAA, these rules do not extend to special enrollment periods available in the Marketplace.

New Permitted Election Change

This guidance creates a new permitted election change so that a cafeteria plan may allow an employee to prospectively revoke an election of group health plan coverage that provides MEC (and is not a health FSA) provided the following conditions are met:

1. The employee is eligible for a Special Enrollment Period to enroll in a qualified health plan through a Marketplace pursuant to guidance issued by HHS (and any other applicable guidance), or the employee seeks to enroll in a qualified health plan during the Marketplace's annual open enrollment period; and

2. The revocation of the election of group health plan coverage corresponds to the intended enrollment of the employee and any related individuals who cease coverage due to the revocation, in a qualified health plan through a Marketplace, for new coverage that is effective beginning no later than the day immediately following the last day of the original group health plan coverage that is revoked.

For purposes of this election change, a cafeteria plan may rely on the employee's reasonable representation that he or she and any related individuals have enrolled or intend to enroll in a qualified health plan for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

If considering this election change, employers should be aware of the following:

- **Potential liability under the employer mandate.** If the employee that revokes coverage to go to the Marketplace is an FTE of the employer and the employer's coverage is not affordable or does not provide minimum value, the employer may be liable for a penalty assessment should that employee receive a subsidy to purchase Marketplace coverage. This would not otherwise pose a problem because an individual is not eligible for a subsidy when he is enrolled in MEC, regardless of affordability or minimum value.

Employer Action

The two new permitted election changes described in Notice 2014-55 are optional. An employer is not required to adopt them. Employers should consider whether to amend their cafeteria plan to allow for these new permitted election changes on a prospective basis. If offering unaffordable or non minimum value coverage, employers should carefully consider potential penalty exposure under the employer mandate.

If opting to include either (or both) election change events, a plan amendment and notice to participants is required. The plan amendment must be adopted on or before the last day of the plan year in which the elections are allowed. The amendment may be effective retroactively to the first day of the plan year, provided the cafeteria plan operates in accordance with Notice 2014-55 and the employer informs participants of the amendment. Under a special rule, a plan year that begins in 2014 and adopts these new election change rules has until the last day of the plan year that begins in 2015 to amend the plan to adopt the change, provided the employer complies the guidance contained in the Notice.

Employers should ensure that any election changes under these rules apply only to MEC, and do not permit changes to the health FSA, dental and/or vision coverage.