

Additional Permitted Election Changes for Health Coverage under § 125 Cafeteria Plans

Notice 2014-55

PURPOSE

This notice expands the application of the permitted change rules for health coverage under a § 125 cafeteria plan (cafeteria plan). In particular, this notice addresses two specific situations in which a cafeteria plan participant may wish to revoke, during a period of coverage (commonly a plan year), the employee's election for employer-sponsored health coverage under the cafeteria plan in order to purchase a Qualified Health Plan through a competitive marketplace established under § 1311 of the Patient Protection and Affordable Care Act, commonly referred to as an Exchange or a Health Insurance Marketplace (Marketplace). The first situation involves a participating employee whose hours of service are reduced so that the employee is expected to average less than 30 hours of service per week but for whom the reduction does not affect the eligibility for coverage under the employer's group health plan. (This may occur, for example, under certain employer plan designs intended to avoid any potential assessable payment under § 4980H of the Internal Revenue Code.) The second situation involves an employee participating in an employer's group health plan who would like to cease coverage under the group health plan and purchase coverage through a Marketplace without that resulting either in a period of duplicate coverage under the employer's group health plan and the coverage purchased through a Marketplace or in a period of no coverage.

This notice permits a cafeteria plan to allow an employee to revoke his or her election under the cafeteria plan for coverage under the employer's group health plan (other than a flexible spending arrangement (FSA)) during a period of coverage in each of those situations provided specified conditions are met. The Treasury Department and the IRS intend to modify the regulations under § 125 consistent with the provisions of this notice, but taxpayers may rely on this notice immediately.

BACKGROUND

Section 125(d)(1) defines a cafeteria plan as a written plan maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Section 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code (with certain exceptions). Qualified benefits include employer-provided accident

and health plans excludable from gross income under §§ 106 and 105(b), but exclude long term care insurance and certain Qualified Health Plans offered through Marketplaces.

Proposed § 1.125-1(c)(1)(iii) of the Income Tax Regulations, consistent with longstanding rules for cafeteria plans, states that a written cafeteria plan must provide that elections are irrevocable except to the extent that the optional change in status rules in Treas. Reg. § 1.125-4 have been included in the cafeteria plan. Treas. Reg. § 1.125-4 provides rules on the circumstances in which a cafeteria plan may permit changes to elections under the plan. Cafeteria plans are not required to allow any of the changes permitted under Treas. Reg. § 1.125-4.

Treas. Reg. § 1.125-4(c) permits a cafeteria plan to allow an employee to revoke an election during a period of coverage with respect to coverage under an accident or health plan as defined in Treas. Reg. § 1.105-5, and make a new election for the remaining portion of the period, if under the facts and circumstances (i) a change in status occurs, and (ii) the election change satisfies the consistency requirements of Treas. Reg. § 1.125-4(c)(3). A change of status for this purpose includes changes in employment status as described in Treas. Reg. § 1.125-4(c)(2)(iii). A change in employment status for this purpose only includes a change in an individual's employment status that results in a change in the individual's eligibility for coverage under the group health plan. Thus, under the existing regulations, a change in employment status that does not result in an employee either becoming or ceasing to be eligible for coverage under the group health plan is not a change in status for which a plan may allow the employee to revoke an election of health coverage under the cafeteria plan during a period of coverage.

Even if the change in status results in a change in eligibility for coverage under the group health plan, any revocation of an election must meet the consistency requirements of Treas. Reg. §§ 1.125-4(c)(3)(i) and 1.125-4(c)(3)(iii). Those requirements provide that if an employee's change in status only results in some of the individuals covered by a group health plan due to their relationship to the employee ceasing to satisfy eligibility requirements for coverage, the employee's election under the cafeteria plan to cancel coverage under the group health plan for any individual other than the individuals losing eligibility fails to correspond with that change in status. Similarly, if a change in status results in an individual gaining eligibility for coverage under a group health plan, an employee's election to cease or decrease coverage for that individual under the cafeteria plan corresponds with the change in status only if the individual enrolls in the coverage for which the individual is newly eligible. That is, an individual gaining eligibility for coverage under a group health plan cannot use that change in status to revoke coverage.

Treas. Reg. § 1.125-4(b) permits a cafeteria plan to allow an employee to revoke an election under the group health plan during a period of coverage and to make a new election that corresponds with the special enrollment rights under § 9801(f). Special enrollment rights under § 9801(f) concern rights to enroll in a group health plan due to loss of other coverage or certain family events, but do not include the ability to enroll in a Qualified Health Plan through a Marketplace.

Interaction with § 4980H

Under § 4980H, an applicable large employer is subject to an assessable payment if the applicable large employer does not offer minimum essential coverage to its full time employees and one or more full time employees receive the premium tax credit under § 36B. Under Treas. Reg. § 54.4980H-3(d), an applicable large employer may use the look-back measurement method to determine the status of an employee as full-time or not full-time. Under the look-back measurement method, for purposes of § 4980H, an employee determined to be full-time based on hours of service during a measurement period must be treated as a full-time employee during a subsequent stability period, regardless of the employee's hours of service during the stability period. Thus, under the look-back measurement method, an employee could have a change in employment status (for example, a change from a full-time position to a part-time position) resulting in a reduction in hours that does not change the employee's status as a full-time employee for purposes of § 4980H, at least for some period of time. Under certain health plan designs intended to avoid any potential assessable payment under § 4980H by offering coverage to employees for all periods during which the employees are classified as full-time employees for § 4980H purposes, the change in employment status would not result in a change in an employee's eligibility for the group health plan. Because the change in employment status would not result in a change in the employee's eligibility for the group health plan, under Treas. Reg. § 1.125-4(c), the cafeteria plan could not allow the employee to change the employee's election under the cafeteria plan during the period of coverage.

Interaction with Enrollment in a Qualified Health Plan Through a Marketplace

Under the current change in status rules under Treas. Reg. § 1.125-4, a cafeteria plan may not allow an employee to revoke an election under the group health plan during a period of coverage solely to enroll in a Qualified Health Plan through a Marketplace. For an individual enrolled through a cafeteria plan in a group health plan with a calendar plan year, the employee may continue his or her coverage under the plan for the remainder of the plan year and then immediately begin coverage under a Qualified Health Plan purchased through a Marketplace. However, an individual enrolled through a cafeteria plan in a group health plan with a noncalendar plan year might not be able to synchronize the change in coverage to avoid an overlapping period

of coverage or a period without coverage because the open enrollment period rules for Marketplaces do not permit the purchase of coverage commencing upon the end of the noncalendar cafeteria plan year.

Also, under Treas. Reg. § 1.125-4(b) a cafeteria plan may allow an employee to revoke an election under a group health plan during a period of coverage and to make a new election that corresponds with special enrollment rights under § 9801(f). Special enrollment rights under § 9801(f) relate only to enrollment in another group health plan, not to enrollment in a Qualified Health Plan offered through a Marketplace. Thus, Treas. Reg. § 1.125-4(b) does not permit a cafeteria plan to allow an employee to revoke an election under a group health plan during a period of coverage and enroll in a Qualified Health Plan offered through a Marketplace as the result of an employee's eligibility to enroll in a Qualified Health Plan during Special Enrollment Period for the Marketplace¹ (even though most of the events giving rise to special enrollment rights under § 9801(f) correspond to the events giving rise to Special Enrollment Periods for a Qualified Health Plan). However, in the case of an event such as a birth or marriage, it may be more advantageous for some individuals to enroll themselves and their families in a Qualified Health Plan rather than to add family members to an employer's group health plan. To permit access to Qualified Health Plans in these cases, this notice permits a cafeteria plan to allow a participating employee to revoke an election in order to obtain coverage through a Marketplace.

GUIDANCE

A cafeteria plan may allow an employee to prospectively revoke an election of coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in § 5000A(f)(1)) provided the following conditions are met:

Conditions for revocation due to reduction in hours of service

- (1) 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

¹ Marketplaces must provide Special Enrollment Periods during which qualified individuals may enroll in Qualified Health Plans offered through Marketplaces. See 45 CFR 155.420(d)

- (2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in another plan that provides minimum essential coverage with the new coverage effective no later than the first day of the second month following the month that includes the date the original coverage is revoked.

A cafeteria plan may rely on the reasonable representation of an employee who is reasonably expected to have an average of less than 30 hours of service per week for future periods that the employee and related individuals have enrolled or intend to enroll in another plan that provides minimum essential coverage 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 coverage is revoked.

Conditions for revocation due to enrollment in a Qualified Health Plan

- (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 the Department of Health and Human Services and any other applicable guidance, or the employee seeks to enroll in a Qualified Health Plan through a Marketplace during the Marketplace's annual open enrollment period; and
- (2) The revocation of the election of coverage under the group health plan 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 coverage that is revoked.

A cafeteria plan may rely on the reasonable representation of an employee who has an enrollment opportunity for a Qualified Health Plan through a Marketplace that the employee and 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.

EFFECTIVE DATE AND PLAN AMENDMENTS

The guidance in this notice is effective on September 18, 2014. The Treasury Department and the IRS intend to amend Treas. Reg. § 1.125-4 to reflect the guidance in this notice. Taxpayers may rely on the guidance in this notice pending further guidance.

To allow the new permitted election changes under this notice, a cafeteria plan must be amended to provide for such election changes. The amendment must be adopted on or before the last day of the plan year in which the elections are allowed, and may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the guidance under this notice and the employer informs participants of the amendment, and provided further that a cafeteria plan may be amended to adopt the new permitted election changes for a plan year that begins in 2014 at any time on or before the last day of the plan year that begins in 2015. However, in no event may an election to revoke coverage on a retroactive basis be allowed.

DRAFTING INFORMATION

The principal author of this notice is R. Lisa Mojiri-Azad of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding the clarification in this notice, contact Ms. Mojiri-Azad at (202) 317-5500 (not a toll free number).