

Dual Guidance Addresses Many Age 26 Adult Child Issues

May 14, 2010

Both the Internal Revenue Service (IRS) and the Tri-Agency Group (the IRS, the Department of Health and Human Services, and the Department of Labor) have released important new guidance on the operation and taxation of the age 26 adult child rules established under the Patient Protection and Affordable Care Act of 2010, as amended by the Health Care and Education Reconciliation Act of 2010 (the Healthcare Reform Law). This guidance, in combination, addresses many important elements of the age 26 adult child rules and generally concludes that such coverage is tax-free to employees, must be extended to all adult children under age 26, and cannot result in a surcharge above the ordinary cost of dependent coverage.

Background

Section 1001(5) of the Patient Protection and Affordable Care Act amends section 2714 of the Public Health Service Act (and by extension, section 715 of ERISA and section 9815 of the Internal Revenue Code (the Code)) to impose an age 26 adult child coverage requirement on health plans. As further amended by the Health Care and Education Reconciliation Act of 2010, the age 26 adult child requirement applies to all group health plans on the first plan year beginning on and after September 23, 2010 (January 1, 2011 for calendar year plans). The Healthcare Reform Law requires employers to provide health coverage to adult children until they attain age 26 without regard to residence, income, or marital status. The only clear exception is for grandfathered group health plans, which are permitted until 2014 to deny coverage for adult children if the adult children are otherwise eligible to enroll in an employer-sponsored health plan. It remains possible that grandfathered collectively bargained plans will be totally exempt from this requirement until their last bargaining agreement terminates; clarification of this possibility will come through additional guidance from the Tri-Agency Group.

The Guidance

The recent guidance has two components: IRS Notice 2010-38 on the tax implications of the age 26 adult child rules, and interim final rules from the Tri-Agency Group for section 54.9815-2714T of the Code (and comparable parts of ERISA and the Public Health Service Act) on the conditions and requirements surrounding the operation and design of the age 26 adult child rules.

IRS Notice 2010-38

IRS Notice 2010-38 is comprehensive in its application and clear in its guidance; namely, that employees will not suffer any withholding or taxation consequences (including FICA, FUTA, and the Railroad Retirement Tax Act) associated with contributions to or benefits from health plan coverage for adult children up to age 26. Further, the Notice clarifies that, if a plan voluntarily continues coverage until the close of the calendar year in which an adult child attains age 26, such coverage remains tax-free. The Notice also clarifies that these new rules are effective March 30, 2010, which will be a relief to employers that voluntarily adopt parts or all of the age 26 adult child rules in advance of the applicable effective date. This favorable tax treatment is also available for Code section 401(h) retiree health accounts in pension plans, voluntary employees' beneficiary associations (VEBAs), and self-employed individuals.

IRS Notice 2010-38 also states that employers can rely on the employee's representation as to the adult child's date of birth.

In addition, IRS Notice 2010-38 states that employees can purchase adult child coverage on a pre-tax premium basis through a cafeteria plan, and allows employers to postpone amending their cafeteria plans to reflect the pre-tax premiums until December 31, 2010.

Note, finally, that employees whose employer voluntarily extends other coverage (such as limited scope nonintegral dental and vision coverage) to adult children will be able to enjoy the same tax-free treatment for contributions to and benefits from such other coverage.

Tri-Agency Group Guidance

The Tri-Agency Group guidance is equally sweeping and clear with respect to the conditions and requirements surrounding the operation and design of the age 26 adult child rules.

Significant components of the Tri-Agency Group guidance are as follows:

- Plans must cover adult children until age 26 without limitations. This means that the days of full-time student certifications, marriage restrictions, residency requirements, or income limitations are at an end. Now, as long as the adult child is under age 26 and a child of the participant, the health plan must offer coverage. The only limited exception is that grandfathered plans can exclude coverage for adult children until 2014 if the adult children are eligible to enroll in an employer-sponsored plan other than the plan of either parent. Plans can, however, exclude coverage for a spouse or a child of an adult child.
- Plans cannot impose a surcharge on adult child coverage. Plans are free to revisit their pricing methodology for all dependents, but must charge the same for each dependent. This may cause plans to move to employee + 1, +2, +3, etc., pricing structures.
- Plans must allow adult children to enroll in the plan even if they were never previously covered under the plan. A transitional rule requires communicating the new opportunity to all employees (such as during the upcoming annual enrollment process in a prominent manner) and offering an open enrollment opportunity of at least 30 days in length to join the plan.

While this enrollment can begin on the first day of the next plan year, the effective date of enrollment must be retroactive to the start of that plan year.

- Plans must treat any adult child enrolling as a special enrollee under the HIPAA portability provisions. This means that the adult child can choose any option available under the plan, their parent can move to the option chosen by the adult child, and a parent who is not currently covered can enroll along with the adult child.
- Plans must allow adult children currently on COBRA to rejoin their parent's coverage under the plan. When the adult children attain age 26 and lose coverage, they are subsequently entitled to another 36 months of COBRA.
- The only circumstances under which a plan can reject adult child coverage would be (i) if the plan does not provide coverage to any dependents or (ii) if the child's parent is no longer eligible for coverage under the terms of the plan.

While the Tri-Agency Group interim regulations are final, they provide for a 90 -day comment period.

Note that an employer that voluntarily adopts the age 26 adult child rules before their effective date can initially choose whether to comply with some or all of the requirements of the Tri-Agency Group guidance. This flexibility exists because the Tri-Agency Group guidance is not effective until plan years beginning on and after September 23, 2010.

Morgan Lewis will continue to monitor developments as further guidance is released regarding the age 26 adult child requirement and its tax implications. If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact the author of this LawFlash, **Andy R. Anderson** (312.324.1177; aanderson@morganlewis.com), or any of the following key members of our cross-practice Healthcare Reform Law resource team:

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