

Health Care Reform: IRS Guidance on Health Coverage for Children Under Age 27

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Cafeteria plans must be amended by December 31, 2010, in order to cover children under age 27 for the 2010 plan year.

Notice 2010–38

The Patient Protection and Affordable Care Act (PPACA), (Pub. L. 111–148) as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA) (Pub. L. 111-152), (collectively, the Act) generally requires group health plans to provide coverage for dependent children up to age 26, effective for the first plan year commencing on or after September 23, 2010. On April 27, 2010, the Internal Revenue Service (IRS) issued Notice 2010–38, which provides guidance on the tax treatment of health coverage and medical reimbursements for children under age 27. Taxpayers may rely on Notice 2010–38 pending the issuance of amended U.S. Treasury regulations.

Exclusion of Employer-Provided Medical Care Reimbursements for Employee's Child Under Age 27

Section 105(b) of the Internal Revenue Code (the Code), 26 U.S.C. § 105(b), generally excludes from an employee's gross income employer-provided reimbursements made to an employee for the medical care of the employee, the employee's spouse or the employee's dependents. Effective March 30, 2010, the Act extended this exclusion to expenses incurred for the medical care of an employee's child who has not attained age 27 as of the end of the taxable year. The child does not need to be a tax-code dependent of the employee to qualify for this exclusion; therefore, criteria such as marital status, full-time student status, gross income limitations and financial support are disregarded. For purposes of the exclusion, a "child" means an individual who is the son, daughter, stepson or stepdaughter of the employee; a legally adopted individual; an individual who is placed with the employee for legal adoption by the employee; or an eligible foster child.

Notice 2010–38 clarifies that the taxable year is the employee's taxable year, employers may assume that an employee's taxable year is the calendar year, a child attains age 27 on the 27th anniversary of the child's date of birth, and employers may rely on the employee's representation as to the child's birthday.

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Exclusion of Employer-Provided Accident or Health Coverage for Employee's Child Under Age 27

Coverage under an employer-provided accident or health plan is excluded from an employee's gross income under Code Section 106. 26 U.S.C. § 106. Notice 2010–38 clarifies that, on and after March 30, 2010, this exclusion extends to coverage for an employee's child who has not reached his or her 27th birthday as of the end of the employee's taxable year. Examples in the Notice clarify that the exclusion is available even if the child under age 27 is working for another employer that offers group health coverage (but the child declines to enroll). However, the exclusion does not extend to the spouse of an employee's child (unless he or she is claimed as a tax dependent by the employee for federal income tax purposes). The IRS intends to retroactively amend the regulations under the Code to reflect this exclusion.

Cafeteria Plans, Flexible Spending Arrangements and Health Reimbursement Arrangements

Notice 2010–38 clarifies that a benefit will not fail to be a qualified benefit under a cafeteria plan—including a health flexible spending arrangement (FSA) or a health reimbursement arrangement (HRA) merely because it provides excludible health coverage or reimbursements for a child who has not turned 27 by the end of an employee's taxable year. Cafeteria plan regulations will be retroactively amended, effective as of March 30, 2010, to include change in status events affecting non-tax-dependent children under age 27, including becoming newly eligible for coverage or eligible for coverage beyond the date on which the child otherwise would have lost coverage as a result of loss of tax-code dependent status.

Transition Rule for Cafeteria Plan Amendments

Cafeteria plans may need to be amended to include employees' children who have not turned 27 by the end of the taxable year. Although cafeteria plan amendments generally may be effective only prospectively, Notice 2010–38 provides that as of March 30, 2010, employers may permit employees to immediately make pre-tax salary reduction contributions for accident or health benefits under a cafeteria plan (including a health FSA) for children under age 27, even if the cafeteria plan has not yet been amended to cover these individuals. In a departure from past guidance, the IRS will permit employers to retroactively amend their cafeteria plans to cover children under age 27, provided such amendment is adopted by December 31, 2010.

Employers can choose to apply more limiting rules for FSA and HRA plans, so amendment to allow reimbursement of expenses for children under age 27 is permitted but not required. However, even if an employer chooses to apply a stricter definition of an eligible dependent child for FSA and HRA purposes, amendment of the cafeteria plan may still be needed to permit pre-tax contributions towards the employee cost of group accident and health insurance coverage.

FICA, FUTA, RRTA and Income Tax Withholding Treatment

Health coverage and reimbursements under a plan for employees and their dependents that are provided for an employee's nondependent child under age 27

are exempt from income tax withholding and are not wages for Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA) and Railroad Retirement Tax Act (RRTA) purposes.

VEBAs, Section 401(h) Accounts and Self-Employed Individuals

Notice 2010–38 clarifies that the term dependent will also include a child who has not attained age 27 as of the end of the taxable year for purposes of Code § 501(c)(9) applicable to VEBAs (26 U.S.C. § 501(c)(9)), Code § 401(h) applicable to retiree medical accounts under qualified plans (26 U.S.C. § 401(h)) and Code § 162(l) applicable to deductions of medical expenses for self-employed individuals (26 U.S.C. § 162(l)).

Implications for Plan Administrators

As noted, cafeteria plans must be amended by December 31, 2010, in order to cover children under age 27 for the 2010 plan year. Amendments for the 2011 and subsequent plan years should be made prospectively. Employer sponsors of group health plans should analyze their current benefit plan design to determine whether they will extend health coverage to children under age 27 in the 2010 plan year or wait until 2011 to implement this change. This analysis should take into consideration the Act's requirement to provide group health coverage for dependent children up to age 26 (especially for off-calendar year plans). In addition, the Notice does not change the tax treatment under the Code for other non-tax dependents, such as domestic partners.

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