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Section 125 Rules to Recognize Two New Permitted Election Changes

Issue Date: September 25, 2014

Last Thursday, the IRS released guidance regarding current Section 125 rules that is likely to be well-received by most employers. The guidance permits two new permitted election changes (prospective revocations) to correspond with some unintended consequences created under the employer shared responsibility rules under Section 4980H and new coverage options available through the public Marketplace (Exchange). For those employers who choose to adopt such changes, the new rules provide more flexibility for individuals in either of two scenarios: (i) those changing from employer-sponsored group health coverage to other minimum essential coverage (MEC) options due to a reduction in hours; or (ii) those changing from employer-sponsored group health coverage to a qualified health plan (QHP) during a special enrollment period or annual open enrollment period through a public Marketplace (Exchange).

Effective Date

The guidance is effective immediately. Section 125 rules will be updated accordingly, but pending further guidance, employers may amend Section 125 (Cafeteria) plans to adopt the newly permitted election changes in accordance with the guidance currently provided.

Background

In general, Section 125 (Cafeteria) plan rules do not allow mid-year changes in elections through the end of a plan year. If premiums for employer-sponsored group health plan coverage are taken on a pre-tax basis, Section 125 rules allow mid-year election changes only for certain specified events, such as:

- Changes in status (e.g. marriage, adoption, change in employment status, residence change);
- Significant cost changes or significant coverage curtailment/improvement;
- Changes under another employer’s plan; and
- HIPAA special enrollment rights.

Keep in mind that even if the Section 125 rules allow for a mid-year election change, the employers ultimately may decide whether to allow such changes. It is necessary for the plan document to address which, if any, of the events allowed under the Section 125 rules will be recognized for purposes of participant mid-year election changes.

Section 125 Issues Addressed by This Guidance

The guidance addresses two issues that have arisen relative to the interaction between current Section 125 rules and coverage requirements/availability under the Affordable Care Act (ACA).

1. Coverage eligibility due to Section 4980H requirements

Regarding the change in employment status rule, the current Section 125 rules allow an individual to make a mid-year election change only if the change in employment status is accompanied by a change in eligibility for coverage (e.g. change from full-time to part-time and part-time not eligible under the terms of the plan). For those employers choosing to implement the look-back measurement method to determine full-time status beginning in 2015, employees determined to be full-time are generally considered eligible for coverage through a full corresponding stability period, regardless of whether hours are reduced. The requirement, which is meant to provide a predictable and stable method of offering coverage, created the unintended consequence of requiring that employee contributions be run through a Section 125 (Cafeteria) plan to continue through the end of the stability period regardless of whether the individual is still able to afford the coverage, because the individual does not lose eligibility.



2. Coverage eligibility for a QHP through a public Marketplace (Exchange)

Currently, if an individual is eligible to enroll under another employer-sponsored plan with a different plan year (e.g. eligible under a spouse's employer-sponsored group health plan), Section 125 rules allow for a mid-year election change to correspond with the change in coverage from one plan to the other during the applicable plan's open enrollment period. However, Section 125 rules allow for a mid-year election change to correspond with the change in coverage from one plan to the other during the applicable plan's open enrollment period. However, Section 125 rules do not currently recognize the availability of coverage for a qualified health plan (QHP) through a public Marketplace (Exchange) during the annual open enrollment period. For those individuals with employer-sponsored group health coverage contributions run through a Section 125 (Cafeteria) plan with a calendar year plan, this is not an issue; however, for those with a non-calendar year plan, there is no way to make mid-year election changes to avoid overlapping coverage or a lapse in coverage while transferring between an employer-sponsored group health plan and coverage through a public Marketplace (Exchange).

In addition, the Section 125 rules do not currently recognize the special enrollment period rules of the public Marketplace (Exchange) that allow for enrollment outside of the annual open enrollment period. In most cases, the situations overlap, allowing for a mid-year election change under Section 125 rules and special enrollment rights through a public Marketplace (Exchange), but there are a few exceptions (e.g. for the individual newly eligible for subsidies for a QHP).

Section 125 rule updates

Participants permitted to revoke Section 125 elections due to a reduction in hours

Participants are allowed to prospectively revoke elections for an employer-sponsored group health plan providing minimum essential coverage (MEC) if:

- The employee was in a position that was expected to be full-time (i.e. average 130 or more hours of service per month during the look-back measurement period) and there was a change in status in which the employee was now expected to be part-time but would not lose eligibility for coverage (i.e. eligibility continued through the end of the applicable stability period even though employee would now average fewer than 130 hours of service per month); and
- The employee and any dependents for whom coverage elections were revoked intended to enroll in a MEC plan no later than the first day of the second month following the revocation of coverage.

Participants permitted to revoke Section 125 elections due to QHP coverage availability

Participants are allowed to prospectively revoke elections for an employer-sponsored group health plan providing minimum essential coverage (MEC) if:

- The participant chooses to enroll for a QHP during the public Marketplace (Exchange) annual open enrollment period or the participant qualifies for a special enrollment period to enroll in a qualified health plan (QHP) through a public Marketplace (Exchange); and
- The participant(s) for whom coverage elections are revoked intend to enroll in a QHP plan no later than the day immediately following the revocation of coverage.



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NOTE – under either of the revocations allowed above, the employer may rely on a reasonable representation that the participants intend to enroll in a QHP or another MEC plan in accordance with the allowable time frames.

Plan Amendments

To allow the newly permitted election changes under this notice, the Section 125 (Cafeteria) plan must be amended to adopt such changes on or before the last day of the plan year in which the elections are allowed. The adopted changes may be effective retroactively to the first day of the plan year, provided that the employer informs participants of the amendment and allows participant mid-year election changes only on a prospective basis. Please contact your Benefits Team at PS&F if you have any questions about the amendment or drafting employee communications.

Summary

This welcome guidance allows employers wishing to provide individuals with additional flexibility in regard to Section 125 mid-year election changes due to a reduction in hours or eligibility for a QHP through a public Marketplace (Exchange) to do so, effective immediately, by adopting such changes in their Section 125 plans and notifying participants accordingly.

As always, should you have any questions, please contact your [Parker, Smith & Feek Benefits Team](#).

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