Health Care Reform Part I: Extension of Health Plan Coverage for Dependent Children and Related Tax Benefits

Written by: Douglas R. Chamberlain, co-Chair of Sulloway's Health Care Practice Area

On March 23, 2010, President Obama signed two bills enacting what is arguably the most sweeping reform of the U.S. health care system in history; certainly since the introduction of the Medicare program in 1965. Sulloway & Hollis recently provided its clients and friends with an overview of health care reform, keyed to the effective dates of various provisions of this complex piece of legislation. With this article we begin a series focusing on various aspects of health care reform of particular interest to our clients, whether as individuals, employers, insurers or health care providers. Our first article deals with the important issue of expanded health plan coverage for dependent children.

BACKGROUND

Most U.S. workers obtain health coverage through their employer's group health plan. While these plans aren't required to do so, most also offer coverage for their employees' spouses and dependents, albeit often largely at the employee's expense. The definition of the term "dependent" for this purpose has historically been the province of state law insofar as insured group health plans are concerned, as well as individual policies. For self-insured plans (typically offered by larger employers, unions, etc.) due to the preemption of state law by ERISA, the principal federal law governing employee benefits, to date plan sponsors have largely been free to define dependent status as they pleased.

In the past, both employer group health plans and individual policies have generally provided dependent coverage for children up to age 19, or age 24 if the child was a full-time student. More recently, some states' insurance laws have mandated coverage under insured group plans and individual policies for older children (for example, up to age 26), but frequently (as in New Hampshire) only if the child is unmarried, a student and/or a resident of the state in question.

In any event, for federal tax purposes group health insurance coverage provided to employees' dependents was typically nontaxable only if the dependent satisfied the standard Internal Revenue Code definition, involving a complex interplay of relationship, residency, sources of support, age and tax filing status.

Health care reform has altered this equation in two significant ways: (1) all group health plans and policies must generally offer dependent coverage to children up to age 26; and (2) group health plan benefits and coverage provided to dependent children who have not reached age 27 will now be nontaxable, regardless of whether the child is a dependent for other federal tax purposes.
NEW DEPENDENT COVERAGE REQUIREMENTS

Under health care reform, while an employer's group health plan is not required to offer dependent coverage to eligible employees at the present time, if it does so the plan must generally offer coverage to all children who have not reached age 26, regardless of their residence, student, marital or tax filing status, or indeed any factor other than their relationship to the employee. The new requirement applies to all group health plans in the private, public and nonprofit sectors, insured or uninsured, and regardless of state law; although state laws more protective of the plan participants' interests (for example, mandating dependent coverage for children 26 or older) will still apply. The requirement applies to individual health policies as well. While some health care reform requirements currently do not apply to so-called "grandfathered" plans (generally, those in existence on March 23, 2010 and not materially changed since that date), this requirement applies to all plans (grandfathered or not), with one exception: until January 1, 2014, grandfathered plans can exclude dependent children who have access to coverage through a plan other than that of his or her parents. (Note that the plan of one parent can't exclude the child from dependent coverage on this basis because he or she is eligible for coverage under the other parent's plan, to preclude a "hall of mirrors" effect in this regard.)

The law specifically provides that a plan is not required to offer coverage to children of the dependent child (that is, the employee's grandchildren). Moreover, while married children are eligible for dependent coverage if they are under age 26, the plan is not required to cover the child's spouse. Finally, a plan may not impose a surcharge or other increased premium for dependent coverage for any child below age 26.

EFFECTIVE DATES AND ADMINISTRATIVE DETAILS

Some confusion has arisen concerning when and how this particular health care reform requirement will take effect. The new rule technically applies only as of the first day of the first plan year beginning six months after the enactment of health care reform (that is, plan years beginning after September 23, 2010). Thus, with respect to a calendar year plan, the new requirement would only apply effective January 1, 2011. However, the protective state laws applicable to insured plans would continue to apply prior to that date, although compliance would not yet be required for self-insured and governmental plans. That said, the Obama Administration has encouraged insurers to comply immediately as to insured plans, and many insurers (including those doing business in New Hampshire, such as Anthem and CIGNA) have indicated that they will do so. While insurers can't require the self-insured plans they administer on an ASO (administrative services only) basis to do so, they have encouraged these plans to follow suit, and to date many have done so, or are considering the issue.

If a dependent child nonetheless loses coverage before the plan applies the new rule, when he or she again becomes eligible for dependent coverage, under recently-issued regulations the child must receive notice from the plan and be afforded a window of opportunity of at least 30 days (beginning no later than the first day of the plan year in which the rule first applies) to enroll for extended dependent child coverage. It is
important to note that the child must generally be offered any coverage available under the plan (including dental and vision coverage, although not coverage under an employee assistance plan), and may choose a benefit package different from that selected by the employee. Furthermore, even if the employee isn't covered at all under the plan (but is eligible for coverage), the plan must permit the employee to enroll so as to give the child access to coverage, during a special enrollment period of the sort currently required under HIPAA with respect to changes in family status.

Finally, if the child previously lost dependent coverage under the former rules and is currently receiving plan coverage (for example) as a qualified beneficiary under COBRA, once the rule becomes effective the plan must let the dependent re-enroll as a dependent, if he or she is under age 26. When the child reaches age 26, the plan must give him or her another opportunity to elect COBRA, which may extend coverage for an additional 36 months if the child loses coverage solely by reason of reaching age 26 (and not, for example, termination of the parent's covered employment under the plan). A plan subject to COBRA may therefore be required to provide coverage on some basis to a dependent child up to age 29 (or even longer in some states), regardless of marital or student status, residency or any factor other than the dependent being the child of an employee eligible to participate in the group health plan.

NEW TAX RULES FOR DEPENDENT CHILDREN

A separate provision of the health care reform legislation enacts a new special definition of the term "dependent" solely for purposes of determining whether benefits and coverage provided under a group health plan are nontaxable to the employee in question. This law extends the nontaxability of benefits and coverage provided under a group health plan to dependent coverage afforded any child who has not reached age 27 by the end of the tax year in question.

The new rule covers traditional employer-provided group health plans, but also extends to the deduction of health insurance premiums by self-employed individuals, benefits paid from Section 125 plans (such as health flexible spending accounts (FSAs)) and from health reimbursement accounts (HRAs), benefits paid by voluntary employee benefit associations (VEBAs) and retiree medical benefits funded by certain tax-qualified retirement plans. The new law applies to biological children of the employee and stepchildren, adopted children and those placed for adoption, as well as foster children, without regard to residence, support, student or marital status or any other factor. These tax law changes take effect March 30, 2010.

CONCLUSION

Enhanced dependent care coverage for children up to age 26 is intended to address societal concerns that, for a variety of reasons, young adults often lack direct access to affordable health insurance on their own. This new requirement, which builds on existing state law protections for participants in insured plans, provides a measure of security for these young people and peace of mind for their parents as well, albeit at an additional
cost that will inevitably be borne in the first instance by insurers and employers, and ultimately by workers and the U.S. economy as a whole.

In terms of required steps towards compliance, employers sponsoring group health plans should contact their insurer and/or plan administrator to discuss the applicability of this requirement to their plan (particularly if the plan is grandfathered, as noted above), and whether compliance in advance of the required date is either mandated by the insurer (in the case of an insured plan) or is deemed feasible and appropriate by the sponsor of a self-insured plan. In either case, the plan must furnish employees and their dependents with timely and accurate information concerning their benefit options, including the mandatory minimum 30-day notice of any opportunity to re-elect dependent coverage previously lapsed. Amendments to plan documents may be needed to reflect these changes.

In this regard, employees sponsoring health flexible spending accounts that permit employees to seek reimbursement for qualifying medical expenses for their dependents will need to amend their plans to reflect the tax law changes noted above, effective no earlier than March 30, 2010. The IRS has indicated that plan sponsors will have until December 31, 2010 to amend their plans without penalty. Since other health care reform requirements apply to health FSA plans beginning in 2011, it would be reasonable to considering making the amendments needed to reflect those requirements at the same time.

If you have any questions concerning expanded group health plan coverage for dependent children or any other aspect of health care reform, please contact Doug Chamberlain, Co-Chair of our firm’s Health Care Practice Group.