
New Health Care Reform: Coverage of Adult Dependents

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As a result of the new health care reform laws in the Patient Protection and Affordable Care Act ("PPACA") and the Health Care and Education Reconciliation Act ("HCERA") (collectively, the "Affordable Care Act"), health coverage for adult dependent children was extended to age 26. In addition, the exclusion from income for both the employer-provided coverage and employer-provided reimbursements for medical expenses of such adult dependents was also extended.

The Department of the Treasury, Department of Labor and Department of Health and Human Services recently issued guidance regarding the new rules: IRS Notice 2010-38 (available [here](#)), interim final rules (available [here](#)), a Fact Sheet (available [here](#)) and FAQs (available [here](#)).

Extension of Adult Dependent Coverage Until Age 26

A group health plan or health insurance issuer is generally not required by federal law to make coverage available to a participant's dependent children. Prior to the Affordable Care Act, if coverage was made available for the dependent children, the terms of such coverage would be dictated by the terms of the plan and by state law. Following enactment of the Affordable Care Act, however, if dependent coverage is provided for participants'

children, such coverage must be made available until the child turns 26 years old (i.e., through age 25) regardless of the child's marital status.

This new extended coverage requirement is generally effective for plan years beginning on or after September 23, 2010, but the Affordable Care Act provides a temporary exception for certain "grandfathered health plans"—that is, for group health plans that were in effect on March 23, 2010, the date PPACA was enacted. For plan years beginning before January 1, 2014, grandfathered health plans need only extend dependent coverage to a participant's child until age 26 if the child is not eligible to enroll in another employer-sponsored health plan. This means that if a child was offered coverage by his or her own employer, then the parent's grandfathered plan would not be required to continue dependent coverage to age 26. However, for plan years beginning on or after January 1, 2014, the extended coverage requirement will apply to all plans regardless of whether other coverage is available for the child.

Recently issued regulations make clear that for purposes of the extension of adult dependent coverage to children who have not yet reached age 26, the term "dependent" may only be defined in terms of the relationship between the child and participant. Factors including financial dependency on the participant, residency with the participant, student status, employment, and eligibility for other coverage (except in connection with the special transition rule applicable to grandfathered plans) may not be considered. In addition, although a child's marital status cannot disqualify the child from eligibility for the extended coverage, plans or issuers are not required to cover the spouse or child of an eligible child. Neither the terms of the plan or policy for dependent coverage nor the price of such coverage may vary based on the age of a child (unless the child is age 26 or older).

The regulations also describe transitional relief for a child whose coverage ended or was denied under a group health plan or health insurance coverage before the new laws came into effect. For such individuals, a plan or issuer must give the child an enrollment opportunity that lasts for at least 30 days (regardless of any other open enrollment periods the plan may have). The enrollment opportunity and a written notice must be given no later than the first day of the first plan year beginning on or after September 23, 2010 and if a child elects coverage during the enrollment period, the coverage must begin retroactive to the first day of the first plan year beginning on or after September 23, 2010.

A plan sponsor who offers dependent coverage but who does not offer dependent coverage until age 26 as required by the new law will be subject to a penalty excise tax under Section 4980D of the Internal Revenue Code (the "Code"). Subject to limitations and exceptions, the excise tax is generally \$100 a day for each individual affected by the failure to comply with the law.

Exclusion of Employer-Provided Health Care Benefits Provided with Respect to Children Under Age 27

Prior to the Affordable Care Act, the cost of coverage and employer-provided reimbursements for medical care expenses were excluded from an employee's gross income only to the extent they were for an employee, an employee's spouse, or an employee's dependents. The Code's definition of "dependent" generally limited the exclusion to the employee's children under age 19, or under age 24 if the child was a full-time student.

The Affordable Care Act does not change the tax-law definition of dependent generally but instead adds children who have not yet attained age

27 as of the end of the taxable year as a separate group of individuals eligible for the favorable exclusion from income. Accordingly, if an employee's child has not reached age 27 as of the end of the employee's taxable year, both (i) employer-provided reimbursements made directly or indirectly to the employee for the medical care of the child and (ii) the cost of coverage under an employer-provided accident or health plan are excluded from the employee's gross income.

Under the Code, a child is defined to include an individual who is the son, daughter, stepson or stepdaughter of the employee, including individuals legally adopted by the employee or lawfully placed with the employee for legal adoption by the employee, and eligible foster children. If an individual qualifies as a child under this definition and will not reach age 27 at any time during the taxable year, the child does not also have to qualify as a dependent (e.g., the child does not have to satisfy the principal residence, financial support, and joint tax return rules) for the employee to receive this favorable tax treatment.

This income exclusion rule is effective March 30, 2010, the date the legislation was enacted. Employees who have children who will not have reached age 27 by the end of 2010 are eligible for the new tax benefit from March 30, 2010 forward if the children are already covered under the employer's plan or are added to the employer's plan at any time.

The income exclusion rule is meant to complement the new coverage requirement. The difference in the age limits between the two provisions (i.e. coverage must be available through age 26 while the exclusion is available for children who do not attain age 27 during the taxable year) appears to be intended to cover situations in which a child turns age 26 after the start of a year, and the insurer allows coverage to continue through the

end of the year (as opposed to ending it immediately upon the child's turning age 26). In such a situation, the income exclusion rule would not require any imputation of income for coverage for the period between the child's 26th birthday and the end of the year.

IRS Notice 2010-38 explicitly allows employers with cafeteria plans to permit employees to immediately make pre-tax salary reduction contributions for accident or health benefits under the cafeteria plan (including a health FSA) for children under age 27, even if the plan has not yet been amended to cover such individuals. The plan amendment, however, must be made no later than December 31, 2010, and must be effective retroactive to the first date in 2010 (on or after March 30, 2010) when employees are permitted to make such contributions. In addition, the IRS intends to amend the cafeteria plan regulations, with retroactive effect to March 30, 2010, to permit employees to both revoke and/or make a new election upon change-in-status events affecting nondependent children under age 27 (e.g. when the child becomes newly eligible for coverage or eligible for coverage beyond the date on which he or she would otherwise have lost coverage). Taxpayers may rely on Notice 2010-38 pending the issuance of the amended regulations.

The new laws made parallel amendments effective March 30, 2010 regarding the exclusion of reimbursements for medical care costs for children who have not yet reached age 27 for retiree health accounts in qualified retirement plans, for voluntary employees' beneficiary associations (VEBAs), and for deductions of self-employed individuals for medical care insurance.

For more information on this or other executive compensation and employee benefits matters, contact [Amy A. Null](#) or [Linda K. Sherman](#).

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