

Additional Permitted Election Changes for Health Coverage under

Section 125 Cafeteria Plans

Notice 2022-41

PURPOSE

This notice expands the application of the permitted change-in-status rules for health coverage under a section 125 cafeteria plan (cafeteria plan). In particular, this notice addresses the situation in which, during a period of coverage (typically a plan year), a cafeteria plan participant may wish to revoke the employee's election under the cafeteria plan for other-than-self-only (family) coverage under a group health plan (other than a flexible spending arrangement (FSA)) in order to allow one or more family members to enroll in a Qualified Health Plan (QHP) through a Health Insurance Exchange (Exchange) in the individual market. Under this notice, the employee will be able to elect out of family coverage and into self-only coverage (or family coverage including one or more already-covered related individuals) under that health plan prospectively during a period of coverage, provided specific conditions are satisfied.

The Department of the Treasury and the Internal Revenue Service intend to modify the Income Tax Regulations under section 125 of the Internal Revenue Code (Code) consistent with the provisions of this notice.

Taxpayers may rely on the guidance in this notice for plan amendments allowing elections effective on or after January 1, 2023.

This notice is being issued in conjunction with regulations under section 36B, which provide that the affordability of an offer of group health plan coverage for a related individual is based on the employee's cost to cover the employee and the employee's related individuals. See § 1.36B-2(c)(3)(v)(A)(2); 87 FR 61979 (Oct. 13, 2022).

BACKGROUND

Section 125(d)(1) defines a cafeteria plan as a written plan maintained by an employer under which all participants are employees and under which all participants may choose among two or more benefits consisting of cash and qualified benefits. Section 125(f) generally defines a qualified benefit as any benefit which, with the application of section 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code (with certain exceptions). Qualified benefits include employer-provided accident and health plans excludable from gross income under sections 106 and 105(b), but exclude long term care insurance and certain QHPs.

Consistent with longstanding rules for cafeteria plans, a written cafeteria plan generally must provide that elections are irrevocable, except

to the extent that the optional change-in-status rules in § 1.125-4 have been included in the cafeteria plan.¹ Section 1.125-4 provides rules on the circumstances in which a cafeteria plan may permit changes to elections under the plan. Cafeteria plans are not required to allow any of the changes permitted under § 1.125-4.

Section 1.125-4(c) permits a cafeteria plan to allow an employee to revoke an election during a period of coverage with respect to coverage under an accident or health plan as defined in § 1.105-5 and make a new election for the remaining portion of the period if, under the facts and circumstances, (i) a change in status occurs, and (ii) the election change satisfies the consistency requirements of § 1.125-4(c)(3). A change in status for this purpose includes a change in employment status as described in § 1.125-4(c)(2)(iii). A change in employment status for this purpose includes only a change in an individual's employment status that results in a change in the individual's eligibility for coverage under the group health plan. Thus, under the regulations, a change in employment status that does not result in an employee or a related individual either becoming or ceasing to be eligible for coverage under the group health plan is not a change in status for which a plan may allow the employee to

¹ See, e.g., Prop. Reg. § 1.125-1(c)(1)(iii); 72 FR 43938, 43948 (Aug. 6, 2007).

revoke an election of health coverage under the cafeteria plan during a period of coverage.

Even if the change in status results in a change in eligibility for coverage under the group health plan, any revocation of an election must satisfy the consistency requirements of § 1.125-4(c)(3)(i) and (iii). Those requirements provide that if an employee's change in status results in an individual covered by a group health plan due to the individual's relationship to the employee ceasing to satisfy eligibility requirements for coverage, the employee is not permitted to elect to revoke an election of coverage under the cafeteria plan for any individual who did not lose eligibility. Similarly, if a change in status results in an individual gaining eligibility for coverage under a second group health plan, an employee's election to cease or decrease coverage for that individual under the cafeteria plan is permitted only if the individual enrolls in the coverage for which the individual is newly eligible.

Furthermore, § 1.125-4(b) permits a cafeteria plan to allow an employee to revoke an election under a group health plan during a period of coverage and to make a new election that corresponds with the special enrollment rights under section 9801(f).

The Affordable Care Act² created the ability to enroll in QHPs through an Exchange. Special enrollment rights under section 9801(f) concern rights to enroll in a group health plan due to loss of other coverage or certain family events, but do not include the ability to enroll in a QHP through an Exchange. The ACA includes separate provisions regarding enrollment in QHPs through an Exchange during open and special enrollment periods. In order to allow employees to enroll in a QHP through an Exchange if they would prefer that coverage, Notice 2014-55 (2014-41 IRB 672) expanded the ability of cafeteria plans to allow employees to revoke elections for group health plan coverage in two situations.

The first situation in Notice 2014-55 addresses an employee with a specified reduction in hours. Specifically, a cafeteria plan may allow that employee to revoke prospectively an election for group health plan coverage if (1) the change in that employee's status does not result in the employee ceasing to be eligible under the group health plan; and (2) the revocation of the election of coverage under the group health plan corresponds with the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in another plan that

² The Patient Protection and Affordable Care Act, Pub. L. 111–148 (124 Stat. 119 (2010)), and the Health Care and Education Reconciliation Act of 2010, Pub. L. 111–152 (124 Stat. 1029 (2010)), collectively referred to as the Affordable Care Act or ACA.

provides minimum essential coverage, with the new coverage effective no later than the first day of the second month following the month that includes the date the original coverage is revoked.

The second situation in Notice 2014-55 addresses an employee who is eligible to enroll in a QHP through an Exchange. Specifically, a cafeteria plan may allow an employee to revoke prospectively an election for group health plan coverage if (1) the employee is eligible for a special enrollment period to enroll in a QHP through an Exchange pursuant to guidance issued by the Department of Health and Human Services³ and any other applicable guidance, or the employee seeks to enroll in a QHP during the Exchange's annual open enrollment period; and (2) the revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in a QHP through an Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked. However, Notice 2014-55 does not allow the revocation of an election for group health plan coverage when only related individuals, and not the employee, become eligible to enroll in a QHP through an Exchange.

³ See 45 CFR § 155.420(d).

Section 36B allows a premium tax credit to applicable taxpayers who satisfy certain eligibility requirements, including that an individual in the taxpayer's family enrolls in a QHP through an Exchange for one or more months in which the individual is not eligible for employer-sponsored minimum essential coverage (including group health plan coverage) or certain other minimum essential coverage. See section 36B(c)(2)(B) and § 1.36B-3(c). Section 36B(c)(2)(C) generally provides that an individual is not treated as eligible for group health plan coverage if the coverage offered is unaffordable or does not provide minimum value. However, an individual who enrolls in group health plan coverage is eligible for that coverage, and therefore ineligible for a premium tax credit, irrespective of whether it is affordable or provides minimum value.

Previous regulations under section 36B provided that the affordability of an offer of group health plan coverage for an individual who may enroll in the coverage because of a relationship to an employee of the employer (a related individual) was based on the employee's self-only cost to enroll in the coverage.⁴ This rule was changed in recently issued regulations under section 36B, which provide that the affordability of an offer of group health plan coverage for a related individual is based on the employee's cost to

⁴ See 78 FR 7264 (Feb. 1, 2013).

cover the employee and the employee's related individuals. See § 1.36B-2(c)(3)(v)(A)(2); 87 FR 61979 (Oct. 13, 2022). Affordability of an offer of group health plan coverage to an employee, however, continues to be based on the employee's self-only cost to enroll in the coverage.

Interaction with Current Change-in-Status Rules

Under the current change-in-status rules under § 1.125-4 and Notice 2014-55, a cafeteria plan is not permitted to allow an employee to revoke an election of family coverage under a group health plan during a period of coverage and elect self-only coverage (or family coverage including one or more already-covered related individuals) solely to allow one or more related individuals who had also been enrolled in the group health plan to instead enroll in a QHP through an Exchange (or separate QHPs if there is more than one related individual). This is the case even when the related individuals are newly eligible to enroll in a QHP through an Exchange during a special enrollment period or during the Exchange's annual open enrollment period.

In many instances, the current rules for changes in status would not restrict employees' and related individuals' choices regarding coverage. For a related individual enrolled in a calendar year group health plan through the cafeteria plan offered to an employee, the employee may revoke the

related individual's coverage under the plan during the plan's annual open season at the end of the plan year so that the related individual generally may immediately begin coverage the next calendar year under a QHP, enrolling during the Exchange's annual open enrollment period. However, a related individual enrolled through a cafeteria plan in a group health plan with a non-calendar plan year might not be able to synchronize the change in coverage to avoid either an overlapping period of coverage or a gap in coverage because the existing cafeteria plan change-in-status rules do not allow the revocation of coverage when only related individuals, and not the employee, become eligible to enroll in a QHP through an Exchange.

In addition, under § 1.125-4(b), a cafeteria plan may allow an employee to revoke an election under a group health plan during a period of coverage and to make a new election that corresponds with special enrollment rights under section 9801(f). However, special enrollment rights under section 9801(f) relate only to enrollment in group health plan coverage, not a right to enroll in a QHP through an Exchange.

Finally, there are some circumstances in which a related individual may become eligible for a special enrollment period during a plan year and newly eligible to enroll in a QHP through an Exchange, and a premium tax credit under section 36B may be allowed for the QHP coverage of the

related individual (for example, if a related individual relocates to another state). See 45 CFR § 155.420(d). Under the current change-in-status rules, however, an employee would be unable to revoke family coverage in a group health plan to allow any related individuals to enroll in a QHP through an Exchange while at the same time the employee elects to enroll in self-only coverage (or family coverage including one or more already-covered related individuals) under the group health plan.

As noted previously, under § 1.36B-2(c)(3)(v)(A)(2), affordability of an offer of group health plan coverage for a related individual is based on the employee's cost to cover the employee and the employee's related individuals. Consequently, an employee may wish to revoke the election of group health plan coverage for one or more related individuals so the related individuals may enroll in a QHP through an Exchange and be allowed a premium tax credit for the related individual's QHP coverage. In the case of group health plan coverage elected through a non-calendar year cafeteria plan, however, or in situations in which a premium tax credit would be allowed for a related individual during the plan year if the related individual was enrolled in a QHP through an Exchange and not in the group health plan coverage, current rules require the employee to delay this

change until the plan's annual open enrollment period, even if the employee would prefer to make the change sooner.

GUIDANCE

In addition to the situations described in Notice 2014-55, a cafeteria plan may allow an employee to revoke prospectively an election of family coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in section 5000A(f)(1)) provided the following conditions are satisfied:

(1) One or more related individuals are eligible for a special enrollment period to enroll in a QHP through an Exchange pursuant to guidance issued by the Department of Health and Human Services⁵ and any other applicable guidance, or one or more already-covered related individuals seeks to enroll in a QHP during the Exchange's annual open enrollment period; and

(2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the related individual or related individuals in a QHP through an Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked. If the employee does not enroll in a

⁵ See 45 CFR § 155.420(d).

QHP through an Exchange as set forth in Notice 2014-55, the employee must elect self-only coverage (or family coverage including one or more already-covered related individuals) under the group health plan.

A cafeteria plan may rely on the reasonable representation of an employee that the employee and/or related individuals have enrolled or intend to enroll in a QHP through an Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

EFFECTIVE DATE AND PLAN AMENDMENTS

The guidance in this notice is effective for elections effective on or after January 1, 2023. Taxpayers may rely on the guidance in this notice pending further guidance.

To allow the new permitted election changes under this notice, an employer must amend a cafeteria plan to provide for these election changes. An employer must adopt the amendment on or before the last day of the plan year in which the elections are allowed, and the amendment may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the guidance under this notice and the employer informs participants of the amendment, and provided further that an employer may amend a cafeteria plan to adopt the

new permitted election changes for a plan year that begins in 2023 at any time on or before the last day of the plan year that begins in 2024.

However, in no event may an employer amend a cafeteria plan to allow an election to revoke coverage on a retroactive basis.

EFFECT ON OTHER DOCUMENTS

Notice 2014-55 is amplified.

DRAFTING INFORMATION

The principal author of this notice is Jennifer Friedman of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Jennifer Friedman at (202) 317-5500 (not a toll-free number).