

# HEALTH REFORM **IMPACT**

## What you need to know NOW

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

### **IRS Issues Guidance Permitting Group Health Plans to Eliminate Potential Coverage Gap for Adult Children**

**May 5, 2010**

Last week, the Internal Revenue Service (the "IRS") issued the first significant guidance (IRS Notice 2010-38) under the recently enacted health reform legislation. This guidance addresses the taxation of benefits and reimbursement of expenses in connection with the expansion of coverage to adult children. Importantly, the guidance will permit group health plans and other health insurance issuers to immediately offer this coverage on a tax-favored basis, thus avoiding a potential gap in coverage for new college graduates and other adult children.

As discussed in an earlier Health Reform IMPACT alert<sup>1</sup>, the health reform legislation requires group health plans (including "grandfathered" group health plans<sup>2</sup>) and health insurance issuers that provide dependent coverage for children to continue to make such coverage available to a participant's adult children until they reach age 26. This requirement is effective for plan years commencing after September 22, 2010 (January 1, 2011, for calendar year plans). In addition, the health reform legislation amends several provisions of the Internal Revenue Code to provide favorable tax treatment for the coverage of adult children. Generally, these provisions exclude from an employee's income reimbursements made by an employer for the medical care of an adult child who has not attained age 27 as of the end of the taxable year.

Unfortunately, the effective dates contained in the health reform legislation created the potential for a gap in coverage for many adult children who would otherwise lose their coverage under existing health plans this year. This gap in coverage results from the fact that many existing group health plans currently only permit children to remain covered under their parent's health coverage until age 19, or age 24 in the case of full-time college students. The IRS guidance attempts to bridge this gap by, among other things, (i) confirming that such coverage may be offered on a tax-free basis as of March 30, 2010, (ii) pledging to amend existing regulations to facilitate the tax-favored treatment of this coverage, (iii) loosening the cafeteria plan regulations regarding "changes in status," and (iv) permitting employers to retroactively amend their

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<sup>1</sup> See "Existing Health Plans - Changes Requiring Attention This Year," April 8, 2010, [available here](#).

<sup>2</sup> "Grandfathered" group health plans, however, may continue to exclude adult children under the age of 26 prior to January 1, 2014, if the children are eligible to enroll in another employer-sponsored health plan.

cafeteria plans no later than December 31, 2010, to incorporate these changes.<sup>3</sup>

Prior to the issuance of the IRS guidance, several insurance providers had already announced that they would offer dependent coverage to adult children prior to the effective date of the required changes. The administration is hopeful that the incentives offered under the IRS guidance will cause other insurance providers and employers to follow suit. However, sponsors of "self-insured" group health plans will need to contact their stop-loss carriers and ensure that any necessary amendments or riders to their existing stop-loss agreements are made before they decide to take similar actions. Failure to do so could result in the stop-loss carrier refusing to cover claims incurred by these individuals prior to the effective date of the required coverage.

With college graduations quickly approaching, the recent IRS guidance is welcome news for employers, parents and adult children alike who have been struggling to find alternatives to the potential gap in coverage caused by the effective dates of the health reform legislation. However, employers who sponsor self-insured group health plans and who wish to implement this coverage ahead of the required effective date should proceed with caution to avoid unintended consequences.

If you have questions regarding the information in this client alert, or with respect to other provisions of the health reform legislation as it relates to your employee benefit plans, please contact any of the attorneys in our Employee Benefits Practice Group listed below.

Also, please [click here](#) to visit our special Web page for Health Reform IMPACT.

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<sup>3</sup> Generally, cafeteria plan amendments may only be made prospectively.