



IRS Issues Guidance on Tax-Free Group Health Plan Coverage for Dependents Under Age 27

The Internal Revenue Service recently issued guidance for employers regarding the tax treatment of coverage for adult children up to age 27 as required by the healthcare reform law. This guidance under [IRS Notice 2010-38](#) specifically addresses the new tax implications of providing health coverage for adult children until age 26 and the impact on cafeteria plans, health reimbursement accounts (HRAs) and flexible spending accounts (FSAs). The following is a detailed overview of the IRS guidance from an employer's perspective:

Background: Reform Requires Increase in Dependent Age Limit

The recently passed healthcare reform law requires employer-sponsored group health plans who offer dependent coverage to extend that coverage to adult children until age 26 regardless of student or marital status. This change is effective with the first plan year beginning on or after September 23, 2010. Until 2014, grandfathered plans are not required to provide coverage if the adult child is eligible to enroll in employer-sponsored group health plan coverage (although there is currently no guidance as to what constitutes a "grandfathered plan"). The federal tax laws were also amended by the reform law to provide favorable tax treatment to adult children receiving coverage.

Tax Changes

Under IRS Code Sections 105 and 106, employer-sponsored coverage and employer-provided reimbursements made directly or indirectly to an employee for the medical care of a dependent child are excluded from an employee's gross income. However, as a result of the reform tax law changes effective March 30, 2010, this exclusion is extended to adult children who are under age 27 at the end of the employee's tax year.

Thus, the IRS Code Section 152 rules regarding the dependent's age, support, and residency status do not apply. The adult child must, however, still meet the IRS Code definition of a "child", which is "a son, daughter, stepson, stepdaughter, a child adopted or placed for adoption, and eligible foster child."

Employers are allowed to rely on the employee's representation of the child's date of birth and can assume the employee's tax year is a calendar year.

Impact on Cafeteria Plans, HRAs and FSAs

As mentioned above, the new dependent age limit requirement also affects the tax laws governing cafeteria plans, HRAs and FSAs. The following is a brief overview of these effects:

- **Eligible Participants**

Previously, participation in a cafeteria plan was restricted by tax law to tax dependents of an employee (as defined by IRS Code Section 152). IRS Notice 2010-38 clarifies that a cafeteria plan will not lose its favorable tax status by providing coverage and reimbursements for adult children under age 27 in compliance with the reform law.

- **Mid-Year Changes on Account of Reform**

The IRS will amend its cafeteria plan rules and regulations retroactive to March 30, 2010, to include a change in status event that will allow employees to make mid-year election changes to account for an adult child being covered. This will allow the employee to pay for the child's coverage on a pre-tax basis.

- **Pre-Tax Salary Reductions**

Employers are allowed as of March 30, 2010, to permit employees to immediately make pre-tax salary reductions to pay for coverage under a cafeteria plan (including a health FSA) for adult children under the age of 27, even if the plan documents have not been amended to reflect this change.

- **Amendment of Plan Documents**

The general rule is that cafeteria plan documents can only be amended on a prospective basis. However, employers will now be allowed to make retroactive plan document amendments to allow for the coverage of adult children. All retroactive amendments must be made no later than December 31, 2010, and must be effective on the first date in 2010 when employees are allowed to make pre-tax deductions to cover adult children under age 27 (but no earlier than March 30, 2010).

- **FSA and HRA Reimbursements**

Health FSAs and HRAs are allowed to make reimbursements for adult children who are under age 27 as of the end of the employee's taxable year.