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G. Addition or Significant Improvement of Benefit Package Option

A plan may be drafted to permit a participant to make certain election changes midyear on account of an addition or significant improvement of a benefit package option under the regulations as discussed in the following paragraphs. Alternatively, a sponsor may design the plan to not allow participants to modify their elections for such an event, or only for certain aspects of that event.

This provision applies to elections for qualified benefits other than health FSAs.⁹⁷

1. Regulatory Background

The regulations provide-

Addition or improvement of a benefit package option. If a plan adds a new benefit package option or other coverage option, or if coverage under an existing benefit package option or other coverage option is significantly improved during a period of coverage, the cafeteria plan may permit eligible employees (whether or not they have previously made an election under the cafeteria plan or have previously elected the benefit package option) to revoke their election under the cafeteria plan and, in lieu thereof, to make an election on a prospective basis for coverage under the new or improved benefit package option.⁹⁸

Caution: Check Insurance Policies. Although a benefit improvement may permit a change under the

cafeteria plan, employers and administrators should review the insurance contracts, certificates of coverage, plan documents, etc. that govern the component benefit plan to ensure that employees who failed to previously enroll may enroll midyear if there is a significant benefit improvement. See Section XIII. A significant improvement in coverage is not a special enrollment event under HIPAA that would permit an employee to enroll in health coverage as a matter of right.

2. Scope of Event and Changes Permitted

The regulations permit employees to change their elections to take a newly available option or significantly improved existing benefit, regardless of whether the new or newly improved benefit had been offered before.⁹⁹ Moreover, employees can elect the new or newly improved benefit "whether or not they have previously made an election under the cafeteria plan or have previously elected the benefit package option."¹⁰⁰

Example: Addition of Benefit Package Option. Largeco offers two major medical options: indemnity coverage and an HMO. Employees pay a portion of the cost for coverage under these options through Largeco's cafeteria plan. During open enrollment, Pedro elects to enroll in the HMO and Connor declines major medical coverage. Three months into the plan year, the employer adds a high-deductible health plan (HDHP) as a new major medical option. Under the permitted election change regulations, Pedro can change his election from the HMO to the HDHP and Connor may enroll in the HDHP (but not in the indemnity option or the HMO).

3. What Is a Significant Improvement of Coverage?

The regulations do not define a "significant improvement" of coverage. However, an example in the regulations indicates that a decrease in copayments under an indemnity health plan is a significant improvement of coverage.¹⁰¹ In addition, IRS guidance issued in December 2015 regarding the impact of the U.S. Supreme Court's *Obergefell* decision on employee benefit plans indicates that a midyear change in the terms or operation of a cafeteria plan's underlying benefits to permit coverage of same-sex spouses

(whether due to a plan amendment, a change in an applicable state law to which the plan refers, or a change in the interpretation of an existing plan term) is a significant improvement of coverage.^{101:1} Reductions in deductibles or an increase in medical providers generally available under a provider network would probably also constitute a significant improvement.¹⁰² Additional examples from the IRS of what constitutes a significant improvement of coverage would be welcome.

4. Which Existing Coverage Elections Can Be Dropped?

If a new benefit option is added (or significantly improved), then the cafeteria plan may "permit eligible employees...to revoke their election under the cafeteria plan and, in lieu thereof, to make an election on a prospective basis for coverage under the new or improved benefit package option." The regulations do not address which existing elections can be changed.¹⁰³ Consequently, cautious employers should only allow changes to existing elections of benefits providing similar coverage options-e.g., dental coverage cannot be dropped when an HMO option is added (unless the HMO option includes dental benefits).

5. Application to Employee-Motivated Benefit Additions and Improvements

This permitted election change event should easily accommodate most midyear additions and significant improvements (employer-motivated or otherwise) when an employer makes a change in its benefits menu. But how does it apply where employers allow employees to pre-tax premiums for individual insurance policies?¹⁰⁴ If an employee seeks to pre-tax a different carrier's individual coverage, does this qualify as an addition or significant improvement of an option? Who determines if the new coverage is significantly improved?

IRS officials have informally commented that the "addition or significant improvement" event applies only to employer-initiated changes. Thus, in the absence of a significant coverage improvement, employee-initiated individual policy changes would not seem to qualify where the employer's menu of options has not changed.¹⁰⁵ *Caution:* Individual insurance policies providing major medical coverage to active employees cannot be reimbursed or paid for under a cafeteria plan (regardless of whether the policies are purchased on an Exchange), and paying or reimbursing other types of individual insurance under a cafeteria plan raises compliance issues under ERISA and other laws. See Section X for a discussion of issues raised by allowing employees to pay or be reimbursed for individual insurance policies under a cafeteria plan.

6. DCAP Election Changes-Broad Rules Apply

As discussed in subsection E, broad rules apply to DCAP election changes under the cost or coverage change events. This is illustrated by an example in the regulations involving an employee who wants to make a midyear DCAP election change after finding a new dependent care provider. According to the regulations, the availability of dependent care services from the new provider "is a significant change in coverage similar to a benefit package option becoming available." Consequently, the employer's cafeteria plan may permit the employee to revoke the previous DCAP election and make a new election to reflect the cost of the new child-care provider.¹⁰⁶ The regulations note that the new provider could be a household employee or family member of the employee or spouse, or a person who is "independent of" the employee or spouse. Apparently, there is no requirement that the care provider differ in any substantive way from prior options.

Changes in Dependent Care Providers. If an employee's child is in day care and the employee's mother becomes available to watch the child, can an election change be made? Yes, according to the regulations. IRS officials have further commented that it does not matter that the care provider is a relative, if the participant wants to make an election change because of a change in coverage. For example, a change in coverage occurs even if an employee is switching day-care providers from a grandmother to an aunt. *

* Informal, nonbinding remarks of Harry Beker and Christine Keller, IRS, Office of Chief Counsel, Feb. 28, 2001 ECFC Teleconference.

7. Collectively Bargained Benefit Changes

See subsection D.5 for a discussion of how to treat elections when benefit changes arise mid-plan year as a result of the collective bargaining process.

8. Addition or Significant Improvement of Benefit Package Option Matrix-Some Election Changes a Plan May Permit (Not Exhaustive)

The following matrix reflects some (but not all) of the election changes that are consistent with the addition

or significant improvement of the benefit package option. *Caution:* This matrix is only a partial summary of our views. Consult the rest of this subsection G and the detailed regulations when evaluating a change.

Event	Major medical	Dental and Vision	Health FSA	DCAP	Employee Group Term Life, AD&D, and Disability Coverage
Addition or Significant Improvement of Benefit Package Option [*]	Eligible employees (whether currently participating or not) may revoke their existing election and elect the newly added (or newly improved) option. Though unclear, it appears that tag-along concepts may apply.	Same as previous column.	No change permitted. [†]	Eligible employees (whether currently participating or not) may revoke their existing elections and elect the newly added (or newly improved) option.	Same as previous column.

^{*} Treas. Reg. §1.125-4(f)(3)(iii).

[†] Treas. Reg. §1.125-4(f).

⁹⁷ Treas. Reg. §1.125-4(f)(1).

⁹⁸ Treas. Reg. §1.125-4(f)(3)(iii).

⁹⁹ Treas. Reg. §1.125-4(f)(6), Example 1(iii) (HMO option added so HMO and indemnity options

became available; employees can make an election change).

¹⁰⁰ Treas. Reg. §1.125-4(f)(3)(iii). See also IRS Notice 2015-86, 2015-52 I.R.B. 887 (if the terms or operation of a cafeteria plan's underlying benefits change midyear to permit coverage of same-sex spouses, affected participants can change their elections to add coverage for a same-sex spouse in a benefit in which the participant is enrolled or to add coverage for themselves and a same-sex spouse).

¹⁰¹ Treas. Reg. §1.125-4(f)(6), Example 1(iii).

^{101.1} IRS Notice 2015-86, 2015-52 I.R.B. 887.

¹⁰² Note that a substantial decrease in medical care providers available under an option is considered a significant curtailment of coverage under the regulations. See subsection F.

¹⁰³ In contrast, the proposed regulations expressly limited changes to existing elections of benefits providing "similar coverage." See Prop. Treas. Reg. §1.125-4(f)(3)(iii) (2000).

¹⁰⁴ See Section X for a discussion of issues raised by allowing employees to pay or be reimbursed for individual insurance policies under a cafeteria plan.

¹⁰⁵ Informal, nonbinding remarks of Harry Beker and Christine Keller, IRS, Office of Chief Counsel, Aug. 4, 2000 ECFC Annual Symposium.

¹⁰⁶ Treas. Reg. §1.125-4(f)(6), Example 5.

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