



# Section 125 - Best Practices

**Presented by: Barb Gerken and Greg Stancil  
NAHU Employer-Based Working Group (EWG) Members**

March 2019

# **This compliance corner is sponsored by the LPRT Committee**

**The View from the Top is Great....So  
are the benefits of being there!  
Find out more on NAHU's website,  
search "LPRT"**



**Encouraging excellence in health and benefits insurance professionals since 1942**

# Sponsored by LPRT

## What's the BIG deal?

- Profound Testimonial about YOU
- Distinguished
- Knowledgeable
- Successful
- The ELITE in your profession
- Motivation ...



**NAHU** Leading Producers Round Table



# QUESTIONS?

You may ask your question in the questions box at any time. Any questions that we do not answer during the webinar will be posted on the compliance corner webpage in the coming weeks.

*The information herein should not be construed as legal or tax advice in any way. Regulations, guidance and legal opinions continue to change. The preparer has gathered public information and has attempted to present it in an easily readable and understandable format. Situations vary, technical corrections and future guidance may vary from what is discussed in the presentation.*

*This is meant for informational content only. The presenter makes no warranty of any kind concerning this information. You should seek the advice of your attorney or tax consultant for additional or specific information.*

*This presentation is not to be duplicated or distributed.*

# TODAY'S PRESENTER

## **Barb Gerken**

- Vice President | Director of Employee Benefit Compliance for First Insurance Group.
- Legislative Chair of the Ohio Association of Health Underwriters, member of the NAHU Legislative Council, NAHU Compliance Corner working group, NAHU Employer-Based working group and NAHU Section 125 subcommittee working group.

## **Greg Stancil**

- Senior Account Executive, Director of Healthcare Reform for Scott Benefit Services.
- Member of the NAHU Employer-Based working group and NAHU Section 125 subcommittee working group.

# AGENDA

- **Section 125 Best Practices**
  - Plan Documents
  - Mid-Year Changes
- **NAHU Employer-Based Working Group (EWG), Section 125 subcommittee work**
  - Member FAQ
  - White Papers
  - Legislation and Regulatory Update Suggestions
  - Compliance Corner Webinar
  - Annual Conference Session

# Section 125

- Section 125 of the IRS code outlines the rules for an employer to offer both taxable and non-taxable benefits under a cafeteria plan.
- Benefits offered on a pre-tax basis are qualified benefits.
- Qualified benefits are excluded from an employee's gross wage and not subject to FICA or FUTA taxes.
- An employer's tax liability is also reduced.



# Plan Documents

- A plan document is required for Section 125 plans.
- The written plan must specifically describe all benefits and establish rules for both eligibility and elections.
  - Important to highlight mid-year changes allowed by the employer and insurers.

# The Irrevocable Election Rule

- Regulations issued under Section 125 require employee elections to be irrevocable for the remainder of a Plan Year
- Failure to enforce the irrevocable election rule causes Plan to have “operational failure” which means elections do not receive 125 exemption
- Exceptions found in [Treasury Regulations Section 1.125-4](#)

# Permitted Election Changes

- Employers are not required to allow election changes authorized under federal regulations.
- An election change authorized by regulation must be authorized by the plan and documented in the plan document.
- Most authorized election changes are also not compulsory for insurance carriers
  - HIPAA special enrollment rights are the exception
- For fully insured plans, approval must come from both the insurer and the employer plan sponsor

# HIPAA Special Enrollment Rights

- HIPAA requires group health plans to give special enrollment opportunities to certain employees, dependents and COBRA qualified beneficiaries.
- A “special enrollee” is allowed to enroll or change his or her existing plan option in the plan after:
  - a loss of eligibility for group health coverage, health insurance coverage, (30 days) CHIP or Medicaid; (60 days)
  - becoming eligible for state premium assistance, Medicaid CHIP subsidies; and (60 days)
  - the acquisition of a new spouse or dependent by marriage, birth, adoption or placement for adoption. (30 days)



# HIPAA Special Enrollment Rights

- Special enrollment rights typically apply with respect to:
  - the employee,
  - dependents of the employee and
  - the spouse of the employee.
- Existing family members who may have previously declined coverage have another opportunity to enroll
- Additionally, the participant has the opportunity to choose from “any benefit package available under the plan”

# HIPAA Special Enrollment Rights

- What coverage is affected?
  - Major medical
  - Major medical integrated with dental/vision
- No pretax change permitted:
  - Dependent care
  - HIPAA-excepted health FSA
  - Stand-alone dental/vision
  - Group term life/AD&D/Disability

# Change in Status

## Qualified Changes:

- change in marital status (marriage, divorce or legal separation as defined by the state),
- number of dependents (includes birth, adoption, placement for adoption and death),
- employment status, (when eligibility is affected)
- dependent satisfies or ceases to satisfy eligibility requirements, (rarely used anymore)
- change in residence
- Revocation Due to Reduction in Hours of Service
- Revocation Due to Enrollment in a Qualified Health Plan

# Change in Status

What coverage is affected?

- Major medical
- Major medical integrated with dental/vision
- HIPAA-excepted health FSA
- Dependent care
- Stand-alone dental/vision
- Group term life/AD&D/Disability



# Change in Cost

- Two factors determine election changes that can be made based on a cost change
  - Whether the change is “significant” or not
  - Whether the change is a cost increase or decrease
- There is no guidance defining “significant”
  - This is a “facts and circumstances” issue
  - Employers should have reasonable flexibility here
- Never authorizes a mid-year Health FSA change

# Change in Cost – Not Significant

- The employer may automatically increase or decrease the employee's elections to cover the cost change
- Employees can not drop or add coverage
- Prior to 2007, the cost change had to be initiated by a third party (the carrier)
- Under revised rules, the employer can initiate the cost change

# Change in Cost – Significant

- Employees can choose between accepting the change or changing their election
- For significant cost decreases, non-enrolled employees can add coverage or switch coverage to a similar plan

# Change in Cost – Significant

- For cost increases, enrolled employees can also change or reduce coverage
  - If similar coverage is offered, employees can't drop coverage completely
  - They can only switch to the other coverage even if it is more expensive
  - Similar coverage is basically any coverage of the same line
  - Other coverage may be through another employer (i.e., the spouse's employer) if the plan allows

# Changes in Coverage

- Two factors determine election changes that can be made based on a coverage change
  - Whether the coverage change is a curtailment or improvement
  - Whether a “curtailment” change results in a loss of coverage or not
- Coverage changes must be “significant” to justify an election change.

# Changes in Coverage

- Significant” curtailment means an overall reduction in coverage provided under the plan so as to constitute reduced coverage generally.
- Not merely a physician dropping out of a network
- Never authorizes a mid-year Health FSA change

# Changes in Coverage – Coverage Curtailment

- If the curtailment does not result in a loss of coverage, the employee can elect coverage under a similar plan
- If the curtailment does result in a loss of coverage, the employee can elect coverage under a similar plan or possibly drop coverage
  - Coverage can only be dropped if there is no similar plan (same standards as the cost change rules)

# Changes in Coverage – Improvement

- Employee can drop current election and switch to a newly added benefit option
- “Significant Improvement” is not defined but a reduction in the co-payments or deductibles is sufficient according to regulatory examples
- This provision can be used to change a dependent care account election in a wide variety of child care scenarios
  - Electing a newly available provider or an incumbent provider, etc.



# Change in Coverage Under Another Employer's Plan

- Other employer's plan can be sponsored by same employer or employer of spouse or dependent (or other employer of employee)
- Enables employees to increase or decrease coverage consistent with changes in other employer's offering
- Also prevents "election-lock" for spouses with different open enrollments
- Never authorizes a mid-year Health FSA change



# Medicare or Medicaid Entitlement

- If an employee, spouse or dependent becomes enrolled in coverage under Part A or Part B of Medicare, or Medicaid or loses coverage under these, a cafeteria plan may permit the employee to make an election change to increase, change or revoke coverage of that employee, spouse or dependent under the plan.

# Family Medical Leave Act (FMLA)

- An employee taking FMLA may revoke their election for medical, dental and vision and choose another option for the remaining period of leave.
- Example: An employee qualifies for unpaid FMLA and does not have enough paid time accrued to earn a full salary during the full 12 weeks of leave. The employee requests to revoke coverage during his leave. This is permitted under this Section 125 provision. Upon return, the employee has the right to be reinstated to the coverage in effect prior to the leave.

# Marketplace Related Change Events

- Events added to the regulations under health care reform
- Employer is not required to allow these events
- Does not authorize a mid-year FSA change
- Does not allow retroactive employee election requests

# Marketplace Related Change Events

## Reduction of Hours

- Employee is expected to average less than 30 hours of service per week due to a reduction in hours, yet eligibility for coverage under the employer's group health plan is not affected.
- In this case, the employee may revoke their election even if they continue to be eligible for group health coverage (such as when a look-back measurement period is being utilized), and enroll in another plan that provides minimum essential coverage (MEC).

# Marketplace Related Change Events

## Reduction of Hours

- Employers may rely on a representation from the employee that they have enrolled or intend to enroll in new coverage.
- The employee does not actually have to provide proof of enrollment to drop coverage.

### **When might this event be useful?**

- Employer offers:
- MEC coverage to part-time employees (those working fewer than 30 hours of service a week)- unaffordable, not MV.
- Affordable, MV coverage to full-time employees

# Marketplace Related Change Events

## Reduction of Hours

### **When might this event be useful? - Example**

- John is full-time, but his hours drop below 30 hours of service per week.
- He may choose to revoke coverage in the Affordable, MV coverage and voluntarily move to the MEC coverage offered by that employer (or available elsewhere).
- This is true even if he is in a stability period and eligibility in the full-time plan is not affected.

# Marketplace Related Change Events

## Enrollment in a Qualified Health Plan

- Applies when an employee has experienced a midyear special enrollment period (SEP) event such as:
  - Marriage,
  - Birth or
  - Adoption
- Employee is now eligible to enroll in a qualified health plan (QHP) available in a state health insurance exchange
- Also applies during the marketplace annual open enrollment period
  - Useful to employers sponsoring non-calendar-year plans



# Marketplace Related Change Events

## Enrollment in a Qualified Health Plan

- The employee may revoke their election in the employer's plan midyear and jump over to the exchange
- Employers may rely on a representation from the employee that they have enrolled or intend to enroll in new coverage.
- The employee is not required to provide proof of enrollment to drop coverage.



# Consistency Rule

- Election changes based on “Change of Status” events that are not consistent with the change of status event are not permitted
- The general consistency rule is that a change must be both “on account of” and “correspond with” the change of status event
- The event must affect eligibility under the employer’s plan

# Special Consistency Rules

- In a divorce, death or dependent age out situation, coverage may only be dropped for the applicable individual – no one else
- When eligibility for coverage under another family member's employer plan occurs, the employee's coverage may only be reduced if the other coverage is actually taken.
- Relaxed consistency rules for GTL, Dismemberment and Disability coverages
- Relaxed rules when dependent care account expenses are affected

# Timing of Change Requests

- There is no regulatory limit on how long Section 125 Plans can give participants to submit election change requests.
- Insurance contracts will typically have limits
- Section 125 Plans should also have reasonable limits as allowing open ended changes could be viewed as not “consistent” with the change event
- Recommended: Section 125 Plan limit matches HIPAA special enrollment rights time limits
- Except for newborns, changes can only be prospective

# Documenting Change Requests

- Every change should be documented
- Documentation via electronic media is authorized
- Employers can rely on an employee's certification of the change of status event or that other coverage has or will be obtained
  - Unless the employer has reason to believe otherwise
- Records related to ERISA plans should be kept for 8 years

# Correcting Election Mistakes

- Employer's Administrative Mistakes
- Employee Mistakes: Impossibility Doctrine
  - To determine whether there is clear and convincing evidence of an employee mistake
  - Impossibility: correction is only allowed if it can be established that it was impossible for the employee to benefit from mistaken election.
  - Facts and Circumstances: plan administrator can reasonably ascertain that a mistake has actually occurred.

# Correcting Election Mistakes

“Clear and convincing evidence”

- Is the claim of a mistake a pretext for evading irrevocability rule?
- Was there a clear employer mistake, like a clerical error?
- General rule: put the participant in the place as if the mistake had not occurred.

# Correcting Election Mistakes

General guidelines are that clear and convincing evidence can include:

- Employee's past elections and benefit usage;
- Plausible evidence of a clerical mistake (e.g., \$5,000 input on the system could have been \$500 or \$50, but not likely \$1,390);
- Assessment of the employee's truthfulness;
- Time elapsed since the first payroll date after the election was in force;



# Correcting Election Mistakes

General guidelines are that clear and convincing evidence can include (cont.):

- Changed circumstances experienced by the employee that might be evidence of reconsideration rather than clerical mistake;
- Other extrinsic evidence of a mistake.

**These factors should be applied on a consistent and nondiscriminatory basis.**

# Correcting Election Mistakes

## Example:

- Robert and Sally have no children. When making his election for 2019, Robert elected to contribute \$2,550 to the dependent care FSA. Later, he learns he is ineligible for this plan.
- When there are no eligible dependents, there is clear and convincing evidence that the individual made a mistake.
- The election can be undone, retroactively.
- No real change is involved-as the election was bad from the start.

# Correcting Election Mistakes

## Example #1:

- Robert and Sally have no children. When making his election for 2019, Robert elected to contribute \$2,550 to the dependent care FSA. Later, he learns he is ineligible for this plan.
- When there are no eligible dependents, there is clear and convincing evidence that the individual made a mistake.
- The election can be undone, retroactively.
- No real change is involved-as the election was bad from the start.

# Correcting Election Mistakes

## Example #2:

- John has covered his wife every year since his employment began.
- The employer rolled out a new online enrollment system for 2019.
- John reported trouble enrolling his wife but spoke to his manager about the desire to continue coverage for his wife.
- His first paycheck for 2019 reflects employee-only coverage. John disputes this with HR.

# Correcting Election Mistakes

Example #2:

Clear and convincing evidence:

- John reported the issue quickly, upon review of his first paycheck in 2019
- He has a long history of covering his wife
- He spoke to his manager about difficulties
- The company rolled out a new system

# Correcting Election Mistakes

## Example #3:

- Sue elected \$2,550 for her health FSA in 2019
- Upon review of her annual budget, she determines she made a mistake and cannot afford this payroll deduction.
- Sue asks to reduce it to half (\$1,275).
- Employer is unable to undo this mistake, even if it's just to reduce the election:
  - Financial hardship is not a mistake.

# Correcting Election Mistakes

## Example #4:

- Tom has always been enrolled in the PPO/Health FSA, but decided to switch to the HDHP/HSA in 2019
- Tom did not have a zero balance in his health FSA as of Dec. 31, and is ineligible to make contributions to his HSA until April 1, 2019
- Tom claims he did not understand this, but the employer has proof this was communicated to its participants.
- Tom is requesting to switch his election back to the PPO/health FSA.

# Correcting Election Mistakes

## Example #4:

- Tom does have evidence of past benefit usage to support his request.
- However, not understanding the communications is not a mistake
- If the employer had not communicated that he would be ineligible to use the HSA until April 1 unless his health FSA had a zero balance would change the answer.



# EWG – Section 125 Subcommittee

## 2019 Member Deliverables

- Three Areas of Focus
  - Plan Documents
  - Mid-Year Changes
  - Non-discrimination Testing

# EWG – Section 125 Subcommittee

## 2019 Member Deliverables

- Member FAQ
- White Papers
- Legislation and Regulatory Update Suggestions
- Compliance Corner Webinar
- Annual Conference Session

# EWG – Section 125 Subcommittee 2019 Member Deliverables

The screenshot shows a presentation application interface. On the left is a 'Navigation' pane with a search bar and tabs for 'Headings', 'Pages', and 'Results'. The 'Headings' tab is active, showing a tree structure of topics. The main content area on the right displays a slide titled 'Change in Status' with a blue header. The slide content includes a sub-header 'Gain Spouse (Marriage)' followed by a bulleted list of three items, and another sub-header 'Lose Spouse (Divorce, Death of Spouse, Legal Separation, Annulment)' followed by a bulleted list of three items. The presentation software's top bar includes icons for save, back, and forward, along with a progress indicator showing the current slide is 1 of 7.

Navigation

Search document

Headings Pages Results

- Change in Status
  - Gain Spouse (Marriage)
    - Section 125 Actions Permitted...
    - Plan Switch Allowed? – Yes
    - Tag-Along Rule Applies? – Yes...
  - Lose Spouse (Divorce, Death of S...)
    - Section 125 Actions Permitted...
    - Plan Switch Allowed? – Yes
    - Tag-Along Rule Applies? – Yes...
  - Gain Dependent (Birth, Adoption,...)
    - Section 125 Actions Permitted...
    - Plan Switch Allowed? – Yes
    - Tag-Along Rule Applies? – Yes...
  - Lose Dependent (Death of Child)
    - Section 125 Actions Permitted...
    - Plan Switch Allowed? – Yes
    - Tag-Along Rule Applies? – No
  - Change in Employment Status T...

## Change in Status

### Gain Spouse (Marriage)

- Section 125 Actions Permitted** - Make pre-tax election to enroll or to add spouse and newly acquired children to existing coverage. May also drop or decrease coverage if now enrolled under spouse's plan.
- Plan Switch Allowed?** – Yes
- Tag-Along Rule Applies?** – Yes – pre-existing dependents may also be enrolled.

### Lose Spouse (Divorce, Death of Spouse, Legal Separation, Annulment)

- Section 125 Actions Permitted** - Make pre-tax election change to drop spouse only; make pre-tax election to add self or child if any lose other coverage.
- Plan Switch Allowed?** – Yes
- Tag-Along Rule Applies?** – Yes – any dependents may be enrolled as long as at least one



# QUESTIONS?

You may ask your question  
in the questions box at any time.  
Any questions that we do not answer  
during the webinar will be posted on the  
compliance corner webpage in the  
coming weeks.