

Health Plans

What Increasing the Age of Eligible Dependents Means for Dependent Audits

Employers already are making adjustments to implement the provision of the Patient Protection and Affordable Care Act, enacted in March, that allows employer cafeteria plans to offer health coverage to employees' children until they are 26 years old. The IRS on April 27 issued guidance in Notice 2010-38 on this expansion of coverage and in the process raised the age to 27. (See the June 2010 newsletter, p. 4 and p. 8; also see Tab 600 of the *Handbook* for more on cafeteria plans.)

The change means that health coverage through cafeteria plans and flexible spending accounts (FSAs, see ¶601) provided to employees' children who are under age 27 is excludable from an employee's income. But it also means that making sure just who exactly is a qualified dependent is even more important for an employer.

Handbook editors contacted Michael Smith, the chief executive officer of the firm Consova, for a look at what this change could mean for the effort to verify who can be covered by an employer's benefit plan. Consova is a firm that conducts audits for employers regarding the eligibility for coverage of those for whom their plan is providing benefits. (For related coverage of dependent audits, see April 2010 newsletter, p. 10.)

Q. What impact do you expect the health reform law to have on your business?

A. This is a difficult question to answer since health care reform laws won't affect most of our employer groups until Jan. 1, 2011. We believe, however, there will continue to be a need for employers to conduct dependent verification activities as it can be very useful in cost containment.

Q. Will the health reform law create more work for you?

A. Yes and No. Prior to health care reform we conducted student verification once if not twice a year. Since full-time student status will no longer be applicable after Jan. 1, 2011 we will no longer perform this type of dependent verification. However, we will have some employers asking us to verify whether an over-age dependent (ages 19-26) has group health coverage available to them through their employer after Jan. 1, 2011. Depending on results from over-age dependent verification, it could create more work.

Q. Will health reform create more demand for verification services?

A. Health care reform has changed the way we communicate and market to our employer groups. Our statistics show that verifying eligibility for spouses generates approximately 52 percent of the overall savings from a dependent audit. Health care reform did not address the costs [of providing health coverage] and we expect plans will see generous [cost] increases in the future. Most plans would like to slow down the cost trend so we expect demand for our services but exactly how much is difficult to predict.

Q. What effect will the increase in the age of dependents eligible for coverage under parents' insurance have on employers?

A. Employers will be exposed financially to the expansion of health coverage for dependents. Employers that perform dependent audits today will see the [older] dependent group grow up to 20 percent to 30 percent from previous years. Although the [older] dependent group is a relatively healthy group and does not pose a significant risk, the cost of coverage will be driven upwards. Also, some plans will choose not to verify the relationship of these dependents because of their relatively low cost. We are encouraging our new employer groups to verify the employee-dependent relationship since we see approximately 7 percent of older dependents are not related to the employee.

Q. What effect will the increase in the age of dependents eligible for coverage under parents' insurance have on you and what you do?

A. We will no longer verify the full-time student status. We will, however, verify the employee-dependent relationship and also verify whether the older dependent is employed and has benefits offered to them from their employer.

Q. Have you already begun to see any effects from the increase in the age of dependents eligible for coverage?

A. Yes, many plans in 2010 have decided not to verify full-time student status for dependents that were previously enrolled.

See *Dependents*, p. 7

Questions and Answers

Q. I understand that the rules for flexible spending account (FSA) expenses must be incurred during the period of coverage. An employee has the option of picking up flex plan coverage as a COBRA benefit, or only receiving reimbursement for the time that their flex plan was active.

I need to convey this information to a participant in our plan who feels that she should be able to receive reimbursements through the flex plan although she is no longer making contributions through salary reductions. She has a severance for her medical and dental benefits, but not for her FSA, and she is not interested in making contributions post-tax.

What federal regulations can I cite in responding to her, so she can see in specific language from the government what the rules are regarding such reimbursements?

Dependents (continued from p. 6)

Q. How does Consova provide healthcare eligibility verification identifying employees' dependents that should not be on employers' health plans?

A. There are several audit methodologies being applied in the market place. Some reveal a 2 percent to 3 percent ineligible rate and others produce a 4 percent to 6 percent ineligible rate. Our ineligible rates have consistently been in the 11 percent to 13 percent range.

Over the past seven years, we have varied our audit scope and methodology to meet individual client expectations. But the most plans have asked us to verify eligibility using legitimate documentation to verify the following: (1) employee-dependent relationship and (2) status. Some plans have also adopted working spouse rules and we verify whether an employee's spouse should be affected by this rule. Working spouse rules dictate whether a spouse is eligible/ineligible or whether an employee should contribute a weekly/monthly surcharge for covering their spouse when the spouse is in fact eligible to enroll in their employer's plan.

Q. Has there been a trend regarding demand for the services you provide?

A. We are not seeing a huge change in the trend since 2008. One difference we are noticing is an increase in interest from smaller employers with less than 1,500 employees who typically were not implementing these types of audits in the past. 

A. You can cite material that is found in the proposed cafeteria plan regulations the IRS issued on Aug. 6, 2007. These proposed regulations appear in the *Federal Register* of Aug. 6, 2007 (72 Fed. Reg. 150). The most relevant material concerning COBRA coverage and how it applies to an employee in the scenario described appears on pages 43946, 43947 and 43952. This *Federal Register* is available at <http://edocket.access.gpo.gov/2007/E7-14827.htm> and <http://edocket.access.gpo.gov/2007/pdf/E7-14827.pdf>.

The information in this material includes the following:

Under Treas. Reg. §1.125-4(c)(3)(iv), COBRA premiums for an employer-provided group health plan are qualified benefits if:

- 1) the premiums are excludible from an employee's income under section 106; or
- 2) the premiums are for the accident and health plan of the employer sponsoring the cafeteria plan, even if the fair market value of the premiums is includible in an employee's gross income.

The following example illustrates these rules.

Employer O maintains a cafeteria plan for full-time employees, offering an election between cash and employer-provided accident and health insurance and other qualified benefits. Employees A, B and C participate in the cafeteria plan. On July 1, 2009, Employee A has a qualifying event.

Employee A was a full-time employee and became a part-time employee and for that reason, is no longer covered by Employer O's accident and health plan. Under Treas. Reg. §1.125-4(f)(3)(ii), Employee A changes her election to salary reduce to pay her COBRA premiums.

Employee B previously worked for another employer, quit and elected COBRA. Employee B begins work for Employer O on July 1, 2009, and becomes eligible to participate in Employer O's cafeteria plan on July 1, 2009, but will not be eligible to participate in Employer O's accident and health plan until October 1, 2009. Employee B elects to salary reduce to pay COBRA premiums for coverage under the accident and health plan sponsored by B's former employer.

Employee C and C's spouse are covered by Employer O's accident and health plan until July 1, 2009, when C's divorce from her spouse became final. C continues to be covered by the accident and health plan. On July 1, 2009,

See Q&A, p. 8