

XIV. When May Participant Elections Be Changed?

- | | |
|--|--|
| <p>A. Election Changes: Overview of IRS Guidance and Key Points to Remember</p> <p>B. Checklist for Cafeteria Plan Election Change Requests</p> <p>C. Change in Status</p> <p>D. Cost Changes With Automatic Increases/Decreases in Elective Contributions</p> <p>E. Significant Cost Changes</p> <p>F. Significant Coverage Curtailment (With or Without Loss of Coverage)</p> <p>G. Addition or Significant Improvement of Benefit Package Option</p> <p>H. Change in Coverage Under Other Employer Plan</p> <p>I. Loss of Group Health Coverage Sponsored by Governmental or Educational Institution</p> | <p>J. 401(k) Election Changes</p> <p>K. HIPAA Special Enrollment Rights</p> <p>L. COBRA Qualifying Events</p> <p>M. Judgments, Decrees, or Orders (QMCSOs, etc.)</p> <p>N. Medicare or Medicaid Entitlement</p> <p>O. FMLA Leaves of Absence</p> <p>P. Pre-Tax HSA Contribution Election Changes</p> <p>Q. USERRA Leaves of Absence (Not Specifically Addressed in the Regulations)</p> <p>R. Other Events Not in the Regulations That Might Permit a Mid-Year Election Change</p> <p>S. Administering Mid-Year Election Changes</p> |
|--|--|

A. Election Changes: Overview of IRS Guidance and Key Points to Remember

Cafeteria plans must follow the general principle that participant elections are irrevocable for the period of coverage (generally, the plan year).¹ In other words, a participant ordinarily may not change an election mid-year. But a plan may be designed to allow exceptions to this irrevocability rule, if certain conditions are met.

This Section XIV discusses the following aspects of exceptions to the irrevocability rule:

- the events recognized under the permitted election change regulations and other formal IRS guidance as permitting changes in election—we call these “permitted election change events”;
- the effect of leaves of absence under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) upon cafeteria plan elections;
- certain other events not in the regulations that might permit a mid-year election change; and
- how to administer mid-year election changes.

For an in-depth discussion of the general irrevocability rule, including the general rules governing participant elections, who can make elections, how and when elections should be made, and different election procedures, see Section XIII.

1. Overview of the Permitted Election Change Regulations and Related Guidance

The permitted election change regulations and other formal IRS guidance recognize 14 events as permitting mid-year election changes—that is, as allowing an exception to the general irrevocability rule that applies to participant elections under a cafeteria plan. These events fall into three broad groups:

- *Change in Status.* The change in status event is the one that occurs most frequently. It encompasses a number of different participant “life events” (e.g., marriage, birth, adoption of a child, and various employment status changes).
- *Cost or Coverage Changes.* To the extent that cost or coverage changes under a component benefit plan take effect at the beginning of a cafeteria plan year, these exceptions generally are unnecessary. The changes would simply be communicated to participants as part of the open enrollment process—no election change is involved. But in some cases, these changes occur at other times. For example, a component plan and cafeteria plan may have different

¹ Prop. Treas. Reg. § 1.125-2(a)(1).

plan years. Enabling participants' pre-tax salary reductions to go with the flow of their component plan cost and coverage changes is precisely what this group of events is designed to do.

Do Any of the Cost or Coverage Events Apply to Health FSAs? No. The cost or coverage change events do “not apply to an election change with respect to a health FSA (or on account of a change in cost of coverage under a health FSA).”^{*} See subsections D through I for details.

* Treas. Reg. § 1.125-4(f)(1).

- **Other Laws or Court Orders.** The other laws or court order events are a “grab bag” of unrelated items with one thing in common: They coordinate cafeteria plan election changes with requirements under other, non-cafeteria plan laws (e.g., 401(k) rules, HSA rules, HIPAA, and COBRA). Consequently, applying this group of events adds a layer of complexity not present with the first two groups—some familiarity with those other laws may be needed to apply the cafeteria plan rules appropriately.

Do the Election Change Rules Apply to HSAs? Although HSAs under Code § 223 are qualified benefits under Code § 125,^{*} the permitted election change regulations were finalized before HSAs came into existence and do not address HSAs. However, later-issued IRS guidance addresses HSA election changes.[†] This guidance is discussed in subsection P. For more information about special considerations for HSAs offered through a cafeteria plan, see Section XVI. And for more information about HSAs in general, see *Consumer-Driven Health Care* (EBIA, 2004-present, updated quarterly).

* See Prop. Treas. Reg. § 1.125-1(a)(3)(J).

† Prop. Treas. Reg. § 1.125-2(c); see also IRS Notice 2004-50, 2004-33 I.R.B. 196, Q/A-58.

2. **Key Points to Remember When Relying on Exceptions to the Irrevocability Rule**

Before examining the various events that the IRS has recognized as allowing an exception to the irrevocability rule (i.e., that allow participants to make mid-year election changes), it is important to keep some key points in mind.

a. **Cafeteria Plans Generally do Not Have to Allow Participants to Change Their Elections**

Must a cafeteria plan allow employees to change their elections? Generally no. The permitted election change regulations confirm that a plan may be designed to prohibit all mid-year election changes.² Note that plan sponsors must, however, allow participants qualifying for a HIPAA special enrollment right under a group health plan to pay for such coverage after-tax outside the cafeteria plan.³ In addition, IRS guidance provides that if HSAs are offered through a cafeteria plan, election changes must be allowed at least monthly—a time period that correlates with the HSA monthly eligibility rules.⁴

b. **Plans That Allow Participants to Change Their Elections Must do so in Accordance With IRS Regulations**

Most employers allow participants to change their elections, at least under limited circumstances. Once this road is taken, however, the plan must observe the applicable IRS regulations. The plan can be more restrictive but never more liberal than the regulations allow. For example, a cafeteria plan can offer fewer permitted election change events than what the IRS allows (e.g., by designing the plan to not allow changes in status for health FSAs). Alternatively, a cafeteria plan that offers the same number of permitted election change events as the IRS allows might make one or more of those events more restrictive than what the IRS requires (e.g., by designing the plan so that an event applies to spouses but not to

² Treas. Reg. § 125-4(a) (stating that Code § 125 “does not require a cafeteria plan to permit any of these changes”). But most employers will want to permit a cafeteria plan election change when an individual loses eligibility under the terms of the underlying benefit plan. See Section XIII.

³ See subsection K and Section XIII.

⁴ See subsection P.

dependents). However, a cafeteria plan cannot offer more (or more expansive) change in election events than those recognized by the IRS.

In practice, most employers design their plans to let participants change their elections as often and as widely as the IRS permits.

Important Assumption: Plan Incorporates All Permitted Election Changes. In this Section XIV (and in Section XIII), we have assumed that an employer uses the most expansive approach to permitting elections that is allowed under the regulations—that is, that the plan document is drafted to allow all of the permitted election change events recognized under the regulations and other formal IRS guidance, and to apply the applicable consistency rules as broadly as the IRS allows. But keep in mind that employers are not required to allow all of the permitted election changes.

c. IRS Permitted Election Change Regulations Apply to All Cafeteria Plans

In 2001, the IRS issued final permitted election change regulations, as set forth in Treas. Reg. § 1.125-4.⁵ That same year, the IRS issued final regulations governing the effect of the Family and Medical Leave Act (FMLA) on the operation of cafeteria plans, under Treas. Reg. § 1.125-3.⁶ These regulations were a welcome development in a long line of proposed and temporary regulations creating exceptions to the irrevocability rule.⁷ All cafeteria plans should now be in compliance with these regulations.⁸

d. A Specified Event Must Have Occurred and the Requested Change Must Be Consistent With That Event

An administrator that approves any mid-year election change must first be satisfied that a permitted election change event has occurred. In addition, the requested election change must be consistent with the event, as defined in IRS regulations. The regulations establish special consistency rules for some events; for other events, the regulations identify the various election changes (e.g., the type of coverage that may be changed, how it can be changed, and for whom) that are permitted when the event occurs. Other requirements may also apply.

In subsections C through P, we discuss each of the events recognized by the regulations and other formal IRS guidance as allowing an exception to the irrevocability rule. We explain how to determine whether the event has occurred and which election changes are consistent with the event. Sometimes, one or more events and consistency rules may apply to a single set of facts. There are a few other events, not specified in the regulations or other formal IRS guidance, that might also permit the revocation of an election (e.g., correction of an election mistake or to avoid failing a nondiscrimination test or regulatory requirement). We address these events in subsections Q and R.

3. Quick Reference Table of Permitted Election Change Events

The following is a quick reference table that identifies the events⁹ described in regulations and other formal IRS guidance that could support a mid-year election change (if permitted in the plan document). The

⁵ 66 Fed. Reg. 1837 (Jan. 10, 2001).

⁶ 66 Fed. Reg. 52675 (Oct. 17, 2001).

⁷ Various regulations were issued in 1984, 1989, 1995, 1997, and 2000 that included guidance on election changes. Although the permitted election change regulations have not replaced all of the earlier regulations, they were a huge step toward consolidating the applicable rules.

⁸ Most of the regulations were effective for plan years beginning on or after January 1, 2001. Treas. Reg. § 1.125-4(j). The following provisions applied to cafeteria plan years beginning on or after January 1, 2002: change in status provisions for DCAP benefits and adoption assistance benefits; cost and coverage change rules; obtaining accident or health coverage for an employee's child in response to a judgment, decree, or order; and the definition of similar coverage.

⁹ Prior proposed IRS cafeteria plan regulations (now withdrawn) included another event, cessation of required contributions. See Prop. Treas. Reg. § 1.125-2, Q/A-6(b) (withdrawn). While the regulations gave an example of a participant who failed to make the required premium payment after a separation from service, the exception literally also applied if the participant ceased contributions mid-year without separating from service. This provision does not appear in the 2007 proposed cafeteria plan regulations; the regulatory preamble explains that it was omitted because it had been superseded by the change in status rules in the permitted election change regulations. Preamble to 2007 Proposed Cafeteria Plan Regulations, 72 Fed. Reg. 43938 (Aug. 6, 2007). Prior to that time, IRS officials had informally commented that such a broad reading of the "cessation of required contributions" provision was inconsistent with the general irrevocable election requirement under Code § 125 and that the literal language in the proposed regulations could not be relied upon. Rather, the provision was intended solely to allow former employees to drop their elections. Informal, nonbinding remarks of Harry Beker, Christine Keller, and Janet Laufer, IRS, Office of Chief Counsel, Mar. 31, 2000 ECFC Annual Conference.

table shows the benefit elections to which each event applies and where to find a detailed discussion of the event.

Quick Reference Table of Permitted Election Change Events		
Events Permitting Election Change	Applicable Benefit Elections	Discussed in:
<p>1. Change in Status Six categories of events:</p> <ul style="list-style-type: none"> • change in employee's legal marital status; • change in number of dependents; • change in employment status; • dependent satisfies (or ceases to satisfy) dependent eligibility requirements; • change in residence; and • commencement or termination of adoption proceedings 	Applies to elections for all qualified benefits (e.g., accident or health coverage, group term life, health FSA, and DCAP benefits). Includes detailed consistency rules.	Subsection C.
2. Cost Changes, With Automatic Increases/Decreases in Elective Contributions	Applies to elections for all qualified benefits except health FSAs (see discussion regarding DCAPs).	Subsection D.
3. Significant Cost Changes	Applies to elections for all qualified benefits except health FSAs.	Subsection E.
4. Significant Coverage Curtailment (With or Without Loss of Coverage)	Applies to elections for all qualified benefits except health FSAs.	Subsection F.
5. Addition or Significant Improvement of Benefit Package Option	Applies to elections for all qualified benefits except health FSAs.	Subsection G.
6. Change in Coverage Under Other Employer Plan	Applies to elections for all qualified benefits except health FSAs.	Subsection H.
7. Loss of Group Health Coverage Sponsored by Governmental or Educational Institution	Applies to elections for all qualified benefits that are group health plans except health FSAs.	Subsection I.
8. Changes in 401(k) Contributions	Applies to elections for 401(k) plans.	Subsection J.
9. HIPAA Special Enrollments	Applies to elections for group health plans that are not excepted benefits under HIPAA (see discussion regarding health FSAs).	Subsection K.
10. COBRA Qualifying Events	Applies to elections for group health plans subject to COBRA, including health FSAs.	Subsection L.
11. Judgments, Decrees, or Orders	Applies to elections for plans that provide accident or health coverage, including health FSAs.	Subsection M.
12. Medicare or Medicaid Entitlement	Applies to elections for plans that provide accident or health coverage, including health FSAs.	Subsection N.
13. FMLA Leaves of Absence	Applies to elections for plans that provide accident or health coverage, including health FSAs. Also applies to elections for non-health benefits.	Subsection O.
14. Changes in Pre-Tax HSA Contributions	Applies to elections to make HSA contributions under a cafeteria plan.	Subsection P.