Since our last issue, health care reform has become a reality with the passing of the Patient Protection and Affordable Care Act. We examine the impact of the Act on cafeteria plans and flexible spending accounts in this month’s Compliance Corner. In News & Trends, we take a closer look at “simple cafeteria plans” as well as the most recent extension of the COBRA subsidy program.

In this month’s Ask Ouida, our resident expert Ouida Peterson tackles one of the most common – and confusing – questions about the COBRA subsidy program. Remember, send your questions to askouida@conexis.com and you may get your answer in a future issue of the Comment.

Until next time, thanks for reading.

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Director of Marketing and Sales Operations

Health Care Reform and Cafeteria Plans

The Patient Protection and Affordable Care Act (the “Act”) was signed into law by President Obama on March 23, 2010. Modifications to this Act were introduced with the passage of the Reconciliation Bill, signed into law by President Obama on March 30, 2010.

Commonly referred to as “health care reform,” the Act makes broad changes to the nation’s health care policies, rules, and mechanisms, including significant changes to cafeteria plans and health flexible spending accounts (FSA). The following is a brief overview of the changes that impact cafeteria plans and FSAs - arranged in chronological order:

Effective Immediately

- **Expanded Definition of Dependent**
  The Act expanded the definition of “dependent” in Internal Revenue Code (“Code”) Section 105 for purposes of tax free health coverage to include a “child” who will not turn age 27 during the year. A "child" for this purpose is defined in Code Section 152(f)(1), and includes children, stepchildren, adopted children, and eligible foster children. Participants in health FSAs (and health reimbursement arrangements (HRAs)) that define eligible dependent by reference to Code Section 105 should be able to take advantage of this change without further changes to the plan. If your plan does not define dependent by reference to Code Section 105(b), and you want to allow participants to take advantage of this expanded definition, you will need to revise your plan to account for the change.
Effective January 1, 2011
- Over-the-Counter Drugs and Items
  Under the Act, over-the-counter “medicine or drugs” (other than insulin) can be reimbursed by the plan only if they are prescribed by a physician. This restriction, which applies to over-the-counter medicine or drugs incurred on or after January 1, 2011 (without regard to the plan year of the plan), does NOT apply to over-the-counter supplies such as bandages and first-aid kits which remain eligible for reimbursement.

NOTE: All plans that previously reimbursed expenses for over-the-counter medicines and drugs (either specifically or by general reference to Code Section 213(d)) will need to amend their plans and communicate the changes to employees. Since the restriction goes into effect with regard to expenses incurred on or after January 1, 2011, without regard to the plan year, some plan amendments will be required mid-plan year.

- Simple Cafeteria Plans
  Effective January 1, 2011, certain employers that establish “simple cafeteria plans” are exempt from the Code Section 125 non-discrimination requirements as well as the non-discrimination requirements applicable to the plans offered through the cafeteria plan (e.g. Code Section 129 non-discrimination testing for dependent care FSAs, Code Section 105(h) non-discrimination testing for self-insured medical plans, etc). The Act defines a simple cafeteria plan as a plan “which is established and maintained by an eligible employer,” and for which certain contribution, eligibility and participation requirements are met. In general, an eligible employer is an employer that employed an average of 100 or fewer employees for either of the prior two years. Plans that qualify as a simple cafeteria plan for any given year are treated as meeting any applicable non-discrimination requirements for that year (i.e., non-discrimination testing is not required for these plans).

Effective January 1, 2013
- Health FSA Annual Maximum Limited to $2,500
  Effective for taxable years beginning on or after January 1, 2013, health FSA salary reductions are limited to $2,500 per year. This amount is indexed to the Consumer Price Index (CPI) beginning in 2014.

Additional Information
It is important to note that although the Act is now law, there are many uncertainties which must be clarified through subsequent guidance from the applicable agencies. CONEXIS will continue to monitor ongoing activity surrounding subsequent guidance and issue additional information as it becomes available.

CONEXIS can be reached at (877) CONEXIS (266-3947)
COBRA Subsidy Program Extended
The Continuing Extension Act of 2010 (the Act) was signed into law by President Obama on Thursday, April 15, 2010. The Act extends the COBRA subsidy eligibility period originally introduced under the American Recovery and Reinvestment Act of 2009 (ARRA), as amended by the Department of Defense Appropriations Act, 2010 (2010 DoD Act) and the Temporary Extension Act of 2010 (TEA).

Subsidy Extension
The Act extends the eligibility period for the COBRA subsidy program until May 31, 2010. Individuals that experience an involuntary termination of employment through May 31, 2010 are eligible for the subsidy available under ARRA.

Required Actions
Election notices and procedures must be modified to reflect this new sunset date. Any individuals that experienced a termination of employment on or after April 1, 2010 who received a notice without this new sunset date must receive a new notice and an extended election period (60 days from the date the revised notice is provided).

TEA Eligible Individuals
Under TEA, individuals who experience a COBRA qualifying event that is a reduction in hours of employment (occurring on or after September 1, 2008) that is followed by a subsequent termination of employment (as defined by ARRA) between March 2 and March 31, 2010 are eligible for the subsidy if they are otherwise an assistance eligible individual (AEI). The Act extends this termination of employment period from March 31 to May 31, 2010.

TEA eligible individuals that experience an involuntary termination of employment on or after March 2 and by May 31, 2010 must receive notice of their rights under TEA, as amended by the Act. For more information on TEA, including the right to a second election period for certain individuals, visit our TEA information page here.

NOTE: The Act does not provide an additional, or extended, election opportunity to individuals that fail to take advantage of the second opportunity available under TEA.

Additional Information
CONEXIS will continue to monitor developments related to COBRA and the subsidy program and will provide additional information, including additional guidance issued by the Treasury or DOL, as it becomes available.

Health Care Reform Creates Simple Cafeteria Plans
The Patient Protection and Affordable Care Act of 2010 (the “Act”), signed into law by President Obama on March 23, 2010, introduces “simple cafeteria plans” beginning January 1, 2011. A simple cafeteria plan is a cafeteria plan that is established and maintained by an eligible employer that meets the eligibility, participation, and contribution requirements outlined in the Act.

Cafeteria Plans in General
A cafeteria plan is an employer-sponsored plan that allows employees to choose certain pre-tax benefits or cash. For example, an employee may choose to pay their share of premiums for employer-sponsored health insurance on a pre-tax basis through the plan.

A cafeteria plan must be a written plan (there must be a plan document governing the plan) and may not discriminate in favor of highly compensated or key employees. To ensure compliance with the nondiscrimination rules, plan sponsors are required to perform several nondiscrimination tests each plan year.
Eligible Employer Definition
Under the Act, a small employer is any employer that had, on average, 100 or fewer employees on business days during either of the 2 preceding years. If an employer was not in existence during the prior year, the number of employees is based on the average number of employees that is reasonably expected to be employed on business days during the current year.

- The Act contains a provision for growing businesses that allows employers who offer a simple cafeteria plan in a qualifying year and then subsequently grow beyond 100 employees to maintain that plan in subsequent years. A growing employer may continue the simple cafeteria plan until the employer exceeds an average of 200 or more employees during a preceding year.

Eligibility, Participation, and Contribution Requirements
To establish and maintain a simple cafeteria plan, an eligible small employer must design their plan to meet the following requirements:

Eligibility and Participation Requirements
- All employees with at least 1,000 hours of service during the preceding plan year must be eligible to participate in the plan (other than employees that may be excluded, as outlined below)
- Each employee that is eligible to participate in the plan must have the right, subject to terms and conditions applicable to all participants, to elect any benefit available under the plan

Allowable Exclusions
The Act allows employers to exclude the following employees from participating in the plan:

- Employees who have not attained the age of 21 before the close of the plan year
- Employees who have less than one year of service with the employer as of any day during the plan year
- Employees covered under a collective bargaining agreement if there is evidence that the benefits covered under the plan were the subject of good faith bargaining between employee representatives and the employer
- Employees described in Code Section 410(b) (3)(c) (relating to non-resident aliens working outside the United States)

Contribution Requirements
- The employer must make a contribution to provide qualified benefits under the plan on behalf of each qualified employee, regardless of whether the employee makes a contribution of their own. This contribution amount must be in an amount equal to:
  - A uniform percentage (not less than 2 percent) of the employee’s compensation for the plan year, or
  - An amount which is not less than the lesser of:
    » 6 percent of the employee’s compensation for the plan year,
    or
    » Twice the amount of the salary reduction contributions of each qualified employee
- The rate of matching contributions made by the employer on behalf of highly compensated or key employees cannot be greater than the rate of matching contributions for non-highly compensated or key employees.

Qualified, Highly Compensated, and Key Employees Defined
For the purposes of the Act, a qualified employee is any employee that is eligible to participate in the cafeteria plan and is not a highly compensated or key employee.

The term “highly compensated employee” is defined in Code Section 414(q). The income limitation for highly compensated employees is adjusted from time to time and is currently set at $110,000. The term “key employee” is defined in Code Section 416(i).
The Benefits of Establishing a Simple Cafeteria Plan
Under the Act, simple cafeteria plans are exempt from the Code Section 125 nondiscrimination requirements as well as the nondiscrimination requirements applicable to the plans offered through the cafeteria plan (e.g. Code Section 129 non-discrimination testing for dependent care FSAs, Code Section 105(h) nondiscrimination testing for self-insured medical plans, etc). Because the sponsor of a simple cafeteria plan is not required to perform nondiscrimination testing, the administrative burden of offering the plan is lessened; making it easier for small employers to offer a plan to their employees.

It’s not unusual for me to get asked the same question more than once; however, after this round of subsidy extension one question keeps coming up. So, this quarter we’re focusing on the one question that has generated the most e-mails (and confusion).

There’s a part in the subsidy extension that says as of March 2, 2010 a reduction in work hours followed by an involuntary termination of employment is now a subsidy-eligible event. Wasn’t it an eligible event before?
Before we get into the March 2 provision, we need to first review the original subsidy law. It will help to keep in mind the most basic provision of COBRA eligibility: you must be on the health plan the day before your qualifying event.

Original Subsidy Law
ARRA clarification regulations explains a simple reduction in work hours – one that reduces hours so that the employee is no longer eligible for insurance – is a COBRA qualifying event; however, if the employee accepts the reduction in work hours and continues to work, it is not a subsidy event. The subsidy criteria require an involuntary termination of employment, not just termination of insurance. So, if the hours are reduced to zero or the employee quits as a result of the reduction in work hours, that is considered an involuntary resignation and the person is eligible for the subsidy.

But, how quickly do they have to quit – immediately; before the next pay period; within 30 days? Nothing was specified in the law. And what if the employer reduces the work hours and then eventually terminates the employment completely? This is where the subsidy problems began. Let’s look at an example.

Under the original ARRA provisions, Mary had a reduction in work hours in July 2009; her active coverage ended July 31, 2009 and she was eligible for COBRA continuation beginning August 1, 2009. Mary elected COBRA and continued to work the reduced

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hours. Mary was NOT eligible for the subsidy since she was still working for the company (i.e. there was no involuntary termination of employment.)

In October 2009, the employer terminated Mary’s employment. This looks like another COBRA event, but Mary already had an 18-month event when she elected COBRA in July (COBRA doesn’t “stack” 18-month events). Had the involuntary termination of employment in October been Mary’s only event, this would have been a subsidy event. However, Mary didn’t have a qualifying event when she was terminated in October because she had already lost her benefits in July with the reduction in work hours which was a non-subsidy event. That is, until the March 2 regulations.

Temporary Extension Act Provisions
Under the Temporary Extension Act of 2010 (TEA), Mary’s situation changes if we change the date of her involuntary termination of employment to a date of March 2 or after. Let’s revisit this example with the new provision.

Mary had a reduction in work hours in July 2009; her active coverage ended July 31, 2009 and she was eligible for COBRA continuation beginning August 1, 2009. Mary elected COBRA and continued to work the reduced hours. Mary was NOT eligible for the subsidy since she was still working for the company.

On March 5, 2010, the employer terminated Mary’s employment. Under the new subsidy event criteria, a reduction in work hours followed by an involuntary termination of employment between March 2 and May 31, 2010, is an eligible subsidy event.

Even if Mary had not elected COBRA at the time of her original reduction in work hours (July 31, 2009), she will have another opportunity to activate COBRA coverage and the subsidy beginning April 1, 2010 (assuming Mary’s employer’s plan is a month to month plan). Had she been covered on the Plan at the time of termination of employment, coverage would have continued until the end of the month.

An important note to make here, is that even though Mary has another opportunity to activate COBRA, her 18 months of COBRA coverage will be calculated from her original COBRA event date, July 2009. This was when she first experienced the loss of coverage due to reduction in work hours.

What is most unusual about this provision is how it just slaps the original COBRA law criteria in the face. Consider the following:

- COBRA law says an individual must be covered on the plan the day before the qualifying event. However, Mary didn’t elect COBRA at the time of her non-subsidy reduction in work hours event. Upon her involuntary termination of employment in March 2010 she is not even covered on the employer sponsored plan and hasn’t been for eight months.
- Even though the involuntary termination of employment didn’t cause her to lose her insurance benefits (she lost them in July 2009 with the reduction in work hours) she still must be offered COBRA as if she had been covered on the Plan. No new pre-existing condition waiting period is applied despite her 8-month gap in coverage.
- This new provision essentially “stacks” 18 month events. Mary’s 18 months of COBRA continuation is calculated from the original event date (July 2009) even if she didn’t elect COBRA the first time around. The new provision is a reduction in work hours followed, within 18 months, by an involuntary termination of employment.

This is just a little confusing, don’t you think? It would be easier to simply say a reduction in work hours is a subsidy event and go on, but legislators haven’t done that. This kind of confusion doesn’t help employers or ex-employees, but this is a new requirement for the COBRA subsidy and something we all need to understand and administer correctly.
Reader’s Poll

This quarter’s Reader’s Poll features a question about employers offering health benefits versus paying a fine. The real-time results are available at the end of the poll.

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