



§125 Election Change Guide

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Medical, Dental or Vision

Health FSA

DCAP

HSA

Change in status events

- Change in marital status
- Change in number of dependents
- Change in employment status, including reduction in hours during stability period
- Loss/gain of dependent status
- Residence change

Change in status events

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- Change in number of dependents
- Change in employment status
- Loss/gain of dependent status

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- Change in number of dependents
- Change in employment status
- Loss/gain of dependent status

Must be permitted to make adjustments at least monthly as desired

HIPAA special enrollments

FMLA

Cost changes

Coverage curtailment

Significant addition/improvement of coverage

Change under another employer's plan

Loss of governmental/educational institution coverage

Exchange enrollment

Medicare/Medicaid entitlement

COBRA qualifying events

Judgments/decrees/orders

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Medicare/Medicaid entitlement

COBRA qualifying events

Judgments/decrees/orders

FMLA

Cost changes

Change in provider or hours

Consistency Rule

Election changes must be consistent with the event that occurred. Election changes *be on account of and correspond with a change in status that affects eligibility for coverage under an employer's plan.*

Tag-Along Rule

Allows additional dependents to be added or removed from coverage upon permitted election changes.

Overview

Cafeteria plans are written plans under which participants (who must be employees) may choose among two or more benefits consisting of cash and qualified benefits (e.g., health insurance). Many employers will structure their cafeteria plan as a salary reduction plan, allowing employees the choice between receiving their full salary in cash or have their salary reduced to purchase pre-tax qualified benefits. When participants make an election under a salary reduction plan, the general rule is that the election must remain in place (i.e., is “irrevocable”) for the duration of the plan year. This means that generally, employees may not make changes to their elections mid-year. However, there are certain instances in which an exception to the general “irrevocability rule” may be made, assuming the plan sponsor has drafted its cafeteria plan to allow it. The purpose of this guide is to outline these exceptions in more detail to provide guidance for brokers and their clients about: 1) when mid-year election changes are permitted; and 2) exactly what changes may be made.

Permitted Election Changes

In general, permitted mid-year election changes fall into 3 categories:

Change in Status Events

These events include common life changes, such as marriage, birth, change in employment status, change in residence, etc.

Cost or Coverage Changes

This permitted election change event is designed to allow participants to make corresponding election changes when an employer makes a change to the plan mid-year that affects the cost of the plan or the type of coverage offered under the plan.

Other Laws or Court Orders

This is a catch-all for several other permitted election change events, which are described in more detail later in this Guide.

§125 election change rules govern when pre-tax election changes are permitted, which is a separate consideration from whether coverage may be added or dropped mid-plan year. In other words, even if the employer and carrier will permit coverage to be added or dropped mid-plan year, whether a corresponding increase or decrease in pre-tax contributions (or salary reductions) may be made through the employer’s cafeteria plan is subject to the §125 election change rules. For example, most employers and carriers are very flexible with requests to drop coverage mid-plan year, but the employee may not be able to reduce pre-tax contributions mid-plan year without violating §125 election change rules. On the flip side, if an employee is asking to add coverage mid-plan year, the plan is not required to allow mid-year enrollment unless a HIPAA special enrollment right is triggered, even if §125 election

change rules would permit an increase in pre-tax contributions. Therefore, when a mid-year change is requested, the employer should first consider whether the plan will permit the mid-year coverage change, but then even if the plan would permit the coverage change, the employer must also consider the §125 election change rules before allowing the change.

Cafeteria plans are not required to allow all changes permitted under §125 rules. The cafeteria plan document can be drafted to be more restrictive, allowing election changes for fewer events. It is most common that cafeteria plan documents will be drafted broadly to permit all changes permitted under §125 rules, but that is not required. When employees request mid-year election changes, it is appropriate to review cafeteria plan document election change language to determine whether the plan permits the change.

Outside of what is permitted under §125 election change rules, we recognize that there are sometimes situations in which an exception is appropriate. For example, an employee may make a mistake when completing elections for the plan year or miss an enrollment deadline; or an employee may experience unique circumstances mid-plan year. Although the employer would not be required to allow a mid-year change without a recognized event, sometimes the employer would prefer to do so when these scenarios present themselves. See the section on Bona Fide Mistakes below for more information.

There are also situations in which it is not totally clear whether an event lends itself to an election change. So long as the change in election is made on a prospective basis, it may not be a big deal to allow an occasional change outside of what is clearly permitted. The reality is that making exceptions on a rare occasion likely poses very little risk to the employer, employee, or the cafeteria plan. That being the case, making a regular practice of doing so is more likely to put the cafeteria plan's tax-favored status at risk. Therefore, we encourage employers to follow §125 election change rules as closely as possible, while recognizing that in some cases, making an exception may be okay.

§125 rules don't contain any specific documentation requirements. Typically, an election change form indicating the reason for the change and attestation by the employee that the change occurred is adequate unless the employer has reason to believe the information is false. However, by plan design, the employer could require something more. For example, birth/marriage certificates or proof of loss/gain of other coverage. If the employer chooses to require something more than an employee attestation, any documentation requirements and time frames should be communicated in plan documentation so that employees have a clear understanding of what is required.

Change in Status Events

Change in status events consist of the following categories of events:

Change in legal marital status

This includes marriage, divorce, death of spouse, legal separation, an annulment for both opposite-sex and same-sex couples. Change in domestic partnership status generally will not qualify as a change in status event under this category unless the change affects a domestic partner's status as a tax dependent for health coverage.

Change in number of dependents

This category includes birth, adoption, placement for adoption, and death of a tax dependent or nondependent children under age 27.

Change in employment status

This includes any change in employment status of the employee, spouse, or dependent that affects eligibility under the cafeteria plan or underlying component benefit. Examples of changes in employment status include beginning or terminating employment; strikes; changes in worksite; switching from salaried to hourly; switching from full-time to part-time; beginning or ending an unpaid leave of absence, etc. NOTE: An employee who is terminated and rehired within 30 days is not permitted to make new elections upon rehire, but instead, previous elections must be reinstated unless another event has occurred permitting a mid-year election change.

Dependent Gains or Loses Eligibility

An election change may be made when a tax dependent gains or loses eligibility. This may be due to age, student status, marriage, etc. In this case, an employee may make a corresponding election change to add or drop coverage for the dependent.

Residence Change

An election change is permissible where a change in residence affects the employee's eligibility for coverage.

Commencement or termination of adoption proceeding (if cafeteria plan provides adoption assistance)

An election change may be made upon commencement or termination of adoption proceedings under an adoption assistance program.

Consistency Rules

Election changes must be consistent with the event that occurred. This is known as the “consistency rule.” This rule requires that election changes be on account of and correspond with a change in status that affects eligibility for coverage under an employer’s plan. For this purpose, two elements must be satisfied:

1. The change in status event must affect eligibility for coverage under an employer’s plan; and
2. The election change must be on account of and correspond with the event.

Tag-Along Rule

The Tag-Along Rule is part of the consistency rules and provides that when a spouse or dependent gains eligibility due to a change in status event, it is “consistent” to also add or remove other eligible individuals to the coverage.

NOTE – there may be conflicts with the Tag-Along Rule and HIPAA Special Enrollment rules (the latter of which only require “special enrollees” to be added to coverage). When a dependent is not a special enrollee, the carrier or stop-loss vendor should agree to the addition before the employer approves the election change request.

Reduction in Hours

As permitted by IRS Notice 2014-55, a plan may permit participants who experience a change in employment status that results in a reduction of hours from at least 30 hours/week to below 30 hours/week to make a midyear election change to drop employer-sponsored minimum essential coverage. This is true even if eligibility is not impacted by the reduction in hours. However, the participant must intend to enroll in another plan that offers minimum essential coverage, and this new coverage must take effect by the first day of the second month following the month in which the original coverage is revoked.

In order to drop employer-sponsored coverage, the coverage in question must provide minimum essential coverage (MEC). This midyear election change event does not apply to health FSAs, nor does it apply to dental/vision coverage that does not provide MEC.

HIPAA Special Enrollment Rights

§125 regulations permit mid-year election changes when an individual experiences a HIPAA special enrollment event. The following are HIPAA special enrollment events:

- The following types of loss of coverage:
 - Loss of other non-COBRA coverage (including group health plan coverage, individual health coverage, Medicaid, or CHIP, but not Medicare or TRICARE);
 - Loss of ALL employer contributions toward other (non-COBRA) coverage; or

- Exhaustion of a COBRA maximum coverage period.
- Acquisition of a new spouse or dependent through marriage, birth, adoption, or placement for adoption.
- Becoming newly eligible for a CHIP/Medicaid premium subsidy.

For loss of coverage, it is important to understand that there must be a loss of eligibility, an exhaustion of the COBRA coverage period, or a complete termination of employer contributions. Voluntary terminations, terminations due to fraud, and/or reductions in employer benefits do not give rise to HIPAA special enrollment events.

When a HIPAA special enrollment event occurs, a plan is required to permit the special enrollee to elect coverage mid-year if the request is made within the required timeframes (30 days for loss of coverage/acquisition of dependent, and 60 days for loss of Medicaid/CHIP or new eligibility for a premium subsidy).

Generally, all benefit packages under a single plan must be available to the special enrollee. But when there are two separate plan options, things are a bit less clear. While some employers may want to permit special enrollees to switch to an entirely new plan during a special enrollment, it will be necessary to confirm that the carrier or stop-loss vendor agrees.

Finally, keep in mind that while §125 recognizes a “tag-along rule” that generally permits employees to add pre-existing dependents to coverage when there is a recognized election change event, HIPAA special enrollment rules only require the plan to allow mid-year enrollment when there is a special enrollment event. In many cases, only certain dependents are considered “special enrollees” under HIPAA rules, so if the employer wants to allow the enrollment of other dependents, it should ensure that the carrier or stop-loss vendor agrees.

FMLA

A plan may permit an employee FMLA-protected leave to revoke an existing election and make a new election for the remaining portion of the period of coverage.

During FMLA-protected leave, an employee covered prior to the leave must be permitted to keep group health plan coverage with the same level of employer contributions that is provided to active employees. If the leave is paid, any employee contributions may continue to be collected from payroll; but if the leave is unpaid, the employee must be able to prepay the employee contributions, pay in after-tax (e.g., via check) while out on leave, or make catch-up contributions upon return to work.

While the employer is required to continue to make coverage available, the employee may generally choose not to continue the coverage while on leave, and then must be given the opportunity to reinstate coverage upon return. §125 rules would permit a corresponding election change during the leave and then upon return to work.

Health FSA

For the health FSA, if the employee chooses to discontinue health FSA coverage during the FMLA-protected leave, any expenses incurred during the leave may not be submitted for reimbursement, even if the health FSA is reinstated upon the employee's return to work. If the employee chooses to reinstate health FSA coverage for the remainder of the plan year upon a return from leave, §125 rules would permit the employee to choose from the following:

- a) reinstate the original election amount and make up the missed contributions (a higher monthly employee contribution would be required for the remainder of the plan year);
- b) reinstate at an election amount pro-rated for the months during which there wasn't coverage (e.g., if originally election \$1200 for the year at \$100/month and out on leave for 3 months, the employee would reinstate at \$900 of coverage and continue at \$100/month upon returning); or
- c) make a new election (i.e., a different amount completely), so long as the employee doesn't exceed the annual limitation (e.g., \$2,750 for 2022).

Dependent Care Account Plan (DCAP)

For the DCAP, the employer is not required to permit continuation of coverage since the DCAP is not a group health plan. The employer could choose to allow continued eligibility for the DCAP during any leave of absence, in which case the employee could continue making contributions similar to the rules set forth above for the health FSA (prepay, pay during the leave, or make catch-up contributions).

However, even if the employee is permitted to continue participating in the DCAP while on FMLA-protected leave, expenses incurred during the leave of absence probably are not eligible for reimbursement (assuming the employee is not gainfully employed). To qualify as an eligible DCAP expense, there are two conditions that must be met:

- the employee must incur the expense to enable the employee and the employee's spouse to work or look for work; and
- the expense must be for the "care" of one or more "qualifying individuals."

If coverage is discontinued during the leave of absence, either because of a loss of eligibility or because the employee chooses to discontinue the coverage, it could be reinstated upon return to an eligible position.

§125 rules would permit the employees to adjust DCAP elections upon going out on FMLA-protected leave as well as upon return.

Cost Changes

§125 regulations permit an employee to make mid-year election changes when there is a significant change (increase or decrease) in the cost of coverage. If the cost change is insignificant, then the employer may simply make the adjustment to participants' contributions accordingly.

If the change in contribution is deemed “significant”, the rules allow participants to change election amounts, switch to another similar plan, enroll (for cost decreases) and even drop coverage if no similar options are available (for cost increases). For this purpose, a “similar coverage option” means coverage for the same category of benefits for the same individuals – regardless of cost. And keep in mind that coverage under another employer’s plan may be considered “similar coverage.” Note that the regulations do not define either “significant” or “insignificant.” As a result, that determination is left to the discretion of the plan sponsor.

Also keep in mind that a change in cost of coverage does not trigger a HIPAA special enrollment right, since there isn’t a loss of eligibility for coverage. Therefore, even if the plan permits a pre-tax election change, it would still be necessary to check whether the carrier or stop-loss vendor will allow mid-year enrollment for those opting to switch to another plan option or newly enroll.

The cost change rules do not apply to health FSAs, but a change in cost of coverage for daycare would generally permit an election change for the DCAP.

Coverage Curtailment

Under §125 election change rules, a pre-tax election may be changed mid-year when there is a significant coverage curtailment, whether the curtailment results in a loss of coverage or not. Examples of coverage curtailment include significant increases in the deductible, copay, or out-of-pocket cost-sharing limits, significant network changes, and reductions in coverage for specific benefits or medical conditions.

The regulations stipulate that “[c]overage under a plan is significantly curtailed only if there is an overall reduction in coverage provided under the plan so as to constitute reduced coverage generally.” However, the analysis for DCAPs is more participant-centered, and may include events such as a reduction in the number of hours needed for care or change in provider who is not a relative.

- If the coverage curtailment does not result in a loss of coverage, a participant may elect similar coverage, but cannot drop coverage. For this purpose, a “similar coverage option” means coverage for the same category of benefits for the same individuals, regardless of cost.

- If the coverage curtailment does result in a loss of coverage, a participant may elect similar coverage or drop coverage (but may only drop coverage if no similar coverage option is available). For this purpose, a loss of coverage is “a complete loss of coverage under a benefit plan.” The following examples illustrate what may qualify as a loss of coverage:
 - Elimination of a benefit package;
 - An HMO ceasing to be available in the area where the participant resides;
 - A substantial decrease in the medical providers available under a coverage option; or
 - A reduction in benefits for a specific type of medical condition for which treatment is being received.

The significant curtailment in coverage rule does not apply to health FSA coverage.

Significant Addition or Improvement of Benefit Package

§125 rules permit a mid-year election change on account of an addition or significant improvement in the benefits offered.

There is no definition of “significant improvement” of coverage, but examples include:

1. Decrease in copayments under an indemnity plan;
2. Reductions in deductibles;
3. Increases in medical providers generally available under a network; and
4. For DCAPs, the availability of dependent care services from a new provider (including a family member).

The significant addition or improvement of benefit package rule does not apply to health FSA coverage.

Change Under Another Employer’s Plan

§125 rules permit mid-year election changes due to “changes in other coverage” for most coverage types.

This event allows election changes in two separate situations:

1. When the other employer plan allows an election change that is permissible under the regulations;

For example, an employee could reduce pre-tax elections to correspond with dropping coverage when a HIPAA special enrollment right allows enrollment under another employer’s plan; similarly, an employee could reduce pre-tax elections to correspond with dropping coverage when a change in employment status triggers eligibility under another employer’s plan.

2. When the other employer plan has a different period of coverage (usually, a plan year). The purpose for this allowance is to avoid the problem of “election lock” where a participant would be locked into the plan selected during their employer’s open enrollment period even if, for example, that participant discovered during their spouse’s employer’s open enrollment period later in the year that less expensive coverage was available.

In each case, a consistency requirement must be satisfied—the new election must be on account of and correspond with the change under another employer plan. Note that under the regulations, “another employer plan” can be a plan of the same employer or another employer.

Loss of Governmental or Educational Institution Coverage

§125 regulations permit mid-year election changes to add major medical coverage when the following types of coverage are lost:

1. Coverage under a state Children’s Health Insurance Program (CHIP);
2. A medical care program of an Indian Tribal Government, the Indian Health Service, or a Tribal Organization;
3. A State health benefits risk pool; or
4. A foreign government group health plan.

While some employers may also permit employees to add dental/vision coverage, it’s not entirely clear that this type of change would be considered consistent with loss of the above types of coverage.

This election change event does not apply to health FSAs, DCAPs, or Group Term Life/Disability/AD&D coverage.

Exchange Enrollment

As permitted by IRS Notice 2014-55, a plan may permit participants who becomes eligible for Exchange coverage (either during the Exchange’s annual open enrollment period or due to a special enrollment event) to drop employer-sponsored minimum essential coverage mid-year for purposes of enrolling in Exchange coverage. Coverage under the Exchange plan must be effective by the first day following the last day of the coverage being revoked.

This mid-year election change event does not apply to health FSAs, nor does it apply to dental/vision coverage that doesn’t provide MEC.

Note that this election change event only applies to gaining eligibility for coverage through the Exchange. It does not apply when coverage through the Exchange is lost (i.e., it would not permit mid-year enrollment in the employer's plan due to loss of Exchange coverage).

Medicare or Medicaid Entitlement

A plan may be drafted to permit employees to make corresponding election changes when they enroll or lose eligibility for Medicare or Medicaid.

Corresponding election changes may also be made to an employee's health FSA. Note that while coverage for the health FSA may be canceled or reduced based on entitlement to Medicare/Medicaid, and may be increased upon loss of Medicaid/Medicare coverage, the reverse is not necessarily true. In other words, an employee is not clearly permitted to increase their health FSA coverage upon Medicare/Medicaid enrollment or decrease it upon Medicare/Medicaid loss.

It is also not entirely clear in the regulations whether employees may make election changes to dental or vision coverage based on changes to Medicare/Medicaid enrollment. While likely okay, it is not clearly permitted.

NOTE: No recognized changes permitted for TRICARE-related coverage or events.

COBRA Qualifying Events

Plan sponsors may permit participants to make certain election changes mid-year for group health plans subject to COBRA (including health FSAs) when a COBRA qualifying event (or similar state law continuation coverage event) occurs. Specifically, plans may be drafted to allow participants to increase their elections to pay for the continuation coverage under the employer's plan. Employees may also be permitted to increase elections to buy COBRA coverage for children who qualify for COBRA coverage based on exceeding age eligibility limits as long as the child still qualifies as a tax dependent for health coverage purposes under the Internal Revenue Code.

Judgments/Decrees/Orders

Employers should ensure that their plans are drafted to permit employees to make mid-year election changes when a judgment, decree, or order resulting from a divorce, legal separation, annulment, or change in legal custody requires health coverage for an employee's child or dependent foster child. This event only permits an employee to add coverage for a child/dependent foster child.

A mid-year election change to drop coverage for a child is permitted only if the order requires that another person provide coverage and that coverage is actually provided. A mid-year election change to drop coverage for a child is not permitted merely because the order's coverage period ends.

Pre-Tax Contributions to a Health Savings Account (HSA)

Participants may change their HSA elections at any time as long as the change is effective prospectively. Employers must permit pre-tax HAS election changes at least monthly, and if any restrictions apply, they must apply to all employees.

Bona Fide Mistakes

While not an official mid-year election change event, the IRS has informally commented that an employer may correct an election where there is clear and convincing evidence that the election was the result of a bona fide mistake. Both employer, employee and third-party mistakes can potentially be corrected using the bona fide mistake exception. Common examples of mistakes that can be corrected include when the employee elected the wrong contribution amount; the employee elected the wrong benefit (e.g., a dependent care FSA instead of a health FSA, or a general-purpose FSA rather than a limited-purpose FSA); the employee forgot to enroll a dependent; etc.

It is generally up to the employer to determine whether there is sufficient evidence of a mistake and, if so, whether to allow the employee to correct the mistaken election. There should be some objective evidence to support that the election really was a mistake rather than just the employee's claim that it was a mistake. For example, the employee elected a benefit that was of no use to them (e.g., a dependent care FSA when they have no qualifying dependents; the election was inconsistent with the employee's regular elections in prior years (e.g., the employee has always elected dental coverage for their children in the past but did not do so this year); or the election is inconsistent with other elections made in the current year (e.g., the employee elected a general-purpose FSA in addition to electing to contribute to an HSA).

The main difference between a mistaken election and other election change events is the election is not just being changed going forward but is typically being undone back to the start of the plan year. The employee should be placed in the position they would have been in had the mistaken election never been made and/or the correct election been in place since the start of the year. Placing the employee in the position they would have been in might entail several different actions including:

- Undoing previous pre-tax elections, reporting them as taxable income and withholding the appropriate payroll taxes.

- Taking additional pre-tax deductions to catch up on contributions that would have occurred under the corrected election.
- Refunding contributions still held by the employer for any benefits that are being dropped.
- The employee repaying the employer for any claims that have been reimbursed to date that exceed the amount collected through payroll.

Because the mistaken election is undone back to the start of the plan year, ideally the mistake should be identified and corrected as early in the plan year as possible. But there is no explicit time limit on how late in the year mistaken elections can be corrected.

While it's within the employer's discretion whether to allow a correction or not, the employer should keep in mind that they are setting a precedent and may be obligating themselves to allow other employees to correct similar mistakes in the future. It is generally a good idea to identify the specific facts that justify allowing a particular correction in order to help determine if future correction requests are similar or not.

Finally, just because it might be possible to correct the employee's pre-tax election does not mean the insurance carriers on the underlying benefit plans will allow the change. Especially where the employee is looking to add coverage that was not previously elected, or to switch between plan options mid-year, the employer should verify with the insurance carrier ahead of time if they will permit the change the employee is looking to make.