

## MAKING CHANGES UNDER YOUR SECTION 125 PLAN

*The following is provided to answer questions frequently asked concerning a Cafeteria Plan under Internal Revenue Code Section 125. This information is not intended as a substitute for specific legal advice from competent counsel on a specific factual situation. For more information, please refer to your employer's Section 125 Plan Document.*

### Q-1 MAY I CHANGE MY BENEFIT ELECTION DURING THE PLAN YEAR?

A-1 The Internal Revenue Service regulations for Sec. 125 plans provide specific rules about changes during a plan year. The rules provide a two-step analysis for determining whether an employee can change his or her election during the year. First, a **change in status event** must have occurred. Second, the employee's requested election change **must be consistent with the event**. Following is a list of the qualified status change events.

1. **Change in employee's legal marital status** — including marriage, divorce, death of spouse, legal separation, and annulment.
2. **Change in number of dependents** — including birth, adoption, placement for adoption, and death. Note that dependent is formally defined in the final regulations to be a tax dependent.
3. **Change in employment status** — any of the following events that change the employment status of the employee, the employee's spouse or the employee's dependent would qualify: a termination or commencement of employment; a strike or lockout; a commencement of or return from an unpaid leave of absence; and a change in worksite. In addition, if the eligibility conditions of the benefit plan of the employer of the employee, spouse or dependent depend on the employment status of that individual and there is a change in that individual's employment status with the consequence then that individual becomes (or ceases to be) eligible under the plan, then that change constitutes a change in employment. It is significant to note that this category would not apply if benefit eligibility is not gained or lost as a result of the event. Thus, for example, an individual who moves from full-time to part-time employment status would not be able to change his or her election under this rule if benefit eligibility remains the same.
4. **Dependent satisfies (or ceases to satisfy) dependent eligibility requirements** — an event that causes the dependent to satisfy or cease to satisfy the requirements for coverage due to attainment of age, gain or loss of student status, marriage or any similar circumstances.
5. **Residence change** — a change in the place of residence of an employee spouse or dependent. For this category, it is particularly important to remember that the residence change *must* affect the employee's eligibility for coverage.
6. **Adoption Assistance**: Commencement or termination of adoption proceedings would allow an election change under an adoption assistance program.

### *The Consistency Requirement*

If a change in status event occurs, employees are allowed to make ***changes consistent with the event***. The regulations limit the election changes that will be consistent with the event. Under the regulations, a uniform rule generally applies to all qualified benefits (accident or health coverage and group term life).

The threshold question under the consistency requirement is whether the election change is on account of and corresponds with a change in status event that affects coverage eligibility of the employee, spouse or dependent for the qualified benefit. An important exception to this general rule is that an impact on eligibility is not required for marital status or employment status events to support election changes for group term life insurance or long-term disability coverage.

Once the threshold standard is met (i.e., the event affects eligibility), ***two specific consistency tests must be satisfied*** — one when dependent eligibility is lost and another when coverage eligibility is gained through another employer plan. In addition, the regulations have been expanded to recognize that certain changes in life or disability coverage can be consistent even if the requested change does not track the increase or decrease in family size, or result in the gain or loss of eligibility.

If the change in status is the employee's divorce, annulment or legal separation from a spouse, the death of a spouse or dependent, or a dependent ceasing to satisfy the eligibility requirements for coverage, the

employee can only cancel accident or health insurance coverage for the spouse or dependent, as applicable. Thus, if a dependent dies or ceases to satisfy the eligibility requirements for coverage, the employee's election to cancel accident or health coverage for any other dependent, for the employee or for the employee's spouse fails to correspond with that change in status.

If an employee, spouse or dependent gains eligibility for coverage under another employer's cafeteria plan (or qualified benefit plan) as a result of a change in marital status or a change in employment status, an employee's election under the cafeteria plan corresponds with that change in status only if coverage for that individual becomes effective or is increased under the other employer's plan.

**Q-2 WHEN MUST I NOTIFY MY EMPLOYER IF I HAVE HAD A "CHANGE IN STATUS EVENT"?**

**A-2** Any change of election because of a change in status event must be made within 30 days of the qualifying event.

**Q-3 WHAT HAPPENS IF THERE IS A CHANGE IN COST OR COVERAGE DURING THE PLAN YEAR?**

**A-3** Mid-year election changes are permitted on account of certain mid-year cost and coverage changes, as provided under IRS Section 125 regulations. It should be noted that these provisions do not apply to health Flexible Spending Accounts.

### *Changes in Cost*

If the cost of a qualified benefits plan decreases during a period of coverage and, under the terms of the plan, employees are required to make a corresponding change in their payments, the cafeteria plan may, on a reasonable and consistent basis, automatically make a prospective decrease in affected employee's elective contributions for the plan. If the cost of a benefit significantly increases during a period of coverage, the cafeteria plan may permit employees either to make a corresponding prospective increase in their payments, or to revoke their elections and, in lieu thereof, to receive on a prospective basis coverage under another benefit package option providing similar coverage.

### *Change in Coverage*

#### ***Coverage Change Rule #1: Significant curtailment***

If the coverage under a plan is significantly curtailed or ceases during a period of coverage, the cafeteria plan may permit affected employees to revoke their elections under the plan and make a new election for coverage under another benefit package option providing similar coverage. Coverage under an accident or health plan is significantly curtailed "only if there is an overall reduction in coverage provided to participants under the plan so as to constitute reduced coverage to all participants generally."

#### ***Coverage Change Rule #2: Addition (or elimination) of benefit package option***

If during a period of coverage a plan adds a new coverage option (or eliminates an existing option) the cafeteria plan may permit affected employees to elect the newly added option (or elect another option if an option has been eliminated) prospectively on a pre-tax basis and make corresponding election changes with respect to other benefit package options providing similar coverage.

#### ***Coverage Change Rule #3: Change in coverage of spouse of dependent under their plan***

A cafeteria plan may permit an employee to make a prospective election that is on account of and corresponds with a change made under the plan of the spouse's, former spouse's, or dependent's employer if: (1) a cafeteria plan or qualified benefits plan of the spouse's, former spouse's, or dependent's employer permits participants to make an election change that would be permitted under the proposed and final regulations; or (2) the cafeteria plan permits participants to make an election for a period of coverage that is different from the period of coverage under the cafeteria plan or qualified benefits plan of the spouse's, former spouse's, or dependent's employer. Under either option, a consistency requirement must be satisfied since the new election must be on account of and corresponds to the change under the plan of the spouse's, former spouse's, or dependent's employer.