November 16, 2022

IRS Fixes the "Family Glitch"

Marketplace Subsidy Eligibility for Family Members no Longer Based on Employee-Only Coverage

On October 13, 2022, the Internal Revenue Service (IRS) unveiled its long awaited final regulations to fix the Affordable Care Act (ACA) "family glitch". On the same day, the IRS also released Notice 2022-41 providing an optional qualifying life event (QLE) for employer cafeteria plans allowing employees to drop family members from medical coverage mid-year to account for their corresponding enrollment in subsidized public health insurance exchange (the "Marketplace") coverage.

This Alert provides a summary of the family glitch issue, the changes made under the final regulations and corresponding IRS cafeteria plan relief, and what all of this means for employers offering medical coverage.

What is the family glitch?

Individuals who meet certain requirements outlined in Section 36B of the Internal Revenue Code (IRC) qualify for subsidies when purchasing medical coverage in the Marketplace. The subsidy comes in the form of Premium Tax Credits (PTC).

An individual is ineligible for a PTC if they receive an offer of affordable, minimum value (MV) coverage from an employer. This is true for both the employee and their family members. IRC Section 36B provides that an individual has an affordable offer of coverage for a given month, if the total required employee contributions for coverage is no more than 9.5% (annually indexed)[1] of household income. However, the existing rules only take the required employee contributions for employee-only coverage into account when determining whether there is an affordable offer of coverage for the employee *and any family members*, without regard to the cost of family coverage.[2]

This means coverage is "affordable" for all family members based on the offer of employee-only coverage, even if the additional cost of covering dependents under family coverage is well above the 9.5% household income threshold.

> **Note:** Individuals with household income greater than 400% of the federal poverty line are also generally ineligible for PTCs, but COVID-19 relief removed this income limitation and enhanced the available Marketplace PTCs through 2025. We addressed this relief in a prior alert.

[1] Affordability percentage is currently 9.61% in 2022 and will decrease to 9.12% in 2023.

[2] This is due to IRC Section 36B's cross-reference to IRC Section 5000A which, for purposes of the individual mandate, defines affordability based on the cost of employee-only coverage.

How we got here

There have been multiple legislative attempts to fix the family glitch over the years, but none were successful. As part of the Biden Administration's push to increase access to affordable quality healthcare, President Biden signed Executive Order 14009, "Strengthening Medicaid and the Affordable Care Act" in 2021. Among many things, it directed the Secretary of the Treasury to reconsider any existing regulations that restrict access to affordable coverage. The Executive Order specifically mentioned affordability for dependents, opening the door to reconsider the family glitch.

The IRS released proposed regulations to fix the family glitch on April 5, 2022, followed by a 60-day comment and review period. While the majority of stakeholders supported the regulations as proposed, there was opposition. The biggest opposing argument was that the IRS did not have the unilateral regulatory authority to fix the family glitch, because the existing PTC language was statutory and required legislative action to change it.

Changes under the final rules

The IRS reviewed the comments and released the final regulations fixing the family glitch with only minor amendments to the proposed rules.

The following is a summary of the two most significant provisions addressing affordability and minimum value determinations for family members, which ultimately affects their eligibility for a PTC for Marketplace coverage in a given month. Both provisions are effective beginning **January 1, 2023**.

Fix to affordability rules for family members

While the affordability test for employees remains the same, the final regulations now include a separate affordability rule for family members.

Under this new rule, a family member has an offer of affordable employer-provided coverage if the employee's cost of family coverage, which is the tier that would, if elected, cover the employee and all eligible family members, is no more than 9.5% (indexed) of total household income. At a high level, household income is adjusted gross income from all sources[3] reported on the taxpayer's federal personal income tax return after certain adjustments.

Since the rules now look at two separate costs of coverage – employee-only and non-self only/family coverage – to determine affordability for employees versus their family members, it is now possible for an employee to be ineligible for a PTC, while family members are PTC eligible. The regulations also address offers of coverage to the employee and/or family members by multiple employers. If any offer of coverage is affordable for a given family member, that offer determines the individual's PTC eligibility.[4]

Note: A family member's eligibility for a PTC does not result in any ACA employer mandate penalties under IRC Section 4980H (see Minimal employer impact).

[3] This includes a spouse's income if the spouses file a joint tax return as well as investment, rental, and/or other business income. Please note that various losses and/or other deductions can lower household income below the taxable compensation amounts reported by employers.

[4] The final regulations include several examples illustrating the various ways multiple offers of coverage can affect individual family member eligibility. One of the examples references a common scenario where family coverage offered by a spouse's employer is unaffordable to the non-employee spouse, but the non-employee spouse has an offer of affordable employee-only coverage through their own employer. In this situation, the offer of affordable employee-only coverage causes the spouse to be ineligible for a PTC.

Sample affordability calculations for family member Marketplace PTC eligibility

To illustrate how to calculate affordability for an employee's family members under the new rules, we will provide examples for a hypothetical ABC Company offering the following four tiers of MV medical coverage:

- Employee-only: $100/month
- Employee + spouse: $400/month
- Employee + child(ren): $350/month
- Family: $600/month

Example 1

Nikki is an ABC Company employee, and she is eligible to enroll herself and her husband in ABC Company's medical coverage. Their total annual household income is $150,000. Her husband's PTC eligibility calculation for 2023 is:

($150,000 × 9.12%) ÷ 12 months = $1,140/month

Since ABC's offer of employee + spouse coverage is less than $1,140/month, Nikki's husband is not eligible for a Marketplace PTC in 2023.

Example 2

Alex is an ABC Company employee. He is a single father with two children under the age of 26 and a total annual household income of $45,000. His children's PTC eligibility calculation for 2023 is:

($45,000 × 9.12%) ÷ 12 months = $342/month

Since ABC's offer of employee + children coverage is more than $342 a month, the offer of coverage is not affordable, and the children are eligible for Marketplace PTCs in 2023.

Example 3

Chris is an ABC Company employee. ABC offers family coverage for him, his wife Ashley, and their child (Andrea). Chris and Ashley's combined annual household income is $80,000. Ashley is also eligible for medical coverage through her employer, XYZ, Inc. XYZ, Inc. offers employee-only coverage for $75/month and family coverage for $700/month. XYZ does not offer employee + child(ren) coverage.

The 2023 PTC eligibility calculation for Ashley and Andrea as Chris's family members is:

($80,000 × 9.12%) ÷ 12 months = $608/month

Ashley is eligible for affordable MV coverage through both ABC Company and XYZ, Inc. (as an employee based on XYZ's employee-only coverage not separately calculated here), so she is ineligible for a Marketplace PTC in 2023. Andrea is eligible for affordable MV coverage through ABC Company, so she is ineligible for a Marketplace PTC in 2023 even though the offer of coverage from XYZ, Inc. is unaffordable to her.

ICHRAs and QSEHRAs: Nothing in the new regulations changes the affordability rules for qualified small employer health reimbursement arrangements (QSEHRAs) or individual coverage health reimbursement arrangements (ICHRAs). The existing ICHRA and QSEHRA affordability rules remain in effect, although the IRS indicated it will consider whether it should issue future guidance to amend these rules.

Separate minimum value test for family members

PTC eligibility is also dependent on whether or not the employer-sponsored coverage offered to an individual meets the ACA's MV standard.[5] An individual is still eligible for Marketplace PTCs when offered affordable medical coverage that does not meet MV.

Under the existing rules, an employee and any family members receive an offer of MV coverage if the coverage offered to the employee:

- Covers at least 60% of total allowed costs for benefits provided under the plan[6] *for the employee*; and
- The benefits include substantial coverage of inpatient hospital services and physician services.

The existing rules do not take whether the benefits offered to family members independently satisfy the MV standard. Although uncommon, it is possible for an offer of coverage to qualify as MV for the employee but not their family members. As an example, this might occur in a plan that:

a) Has an actuarial value close to 60%; and

b) Has separate non-embedded deductibles or out-of-pocket maximum limits for its dependent tiers of coverage. A plan has non-embedded deductibles or out-of-pocket maximum limits when a spouse or dependent enrolled in a tier other than employee-only coverage tier could have to satisfy the entire deductible or out-of-pocket maximum on their own, beyond the individual deductible or out-of-pocket maximum.[7]

The final regulations address this by creating a separate MV rule for family members based on the level of coverage provided to those individuals that generally mirrors the requirement for an offer of MV coverage to the employee. The final regulations also include a safe harbor, which treats an employer as offering MV coverage if it provides the same scope of benefits and cost-sharing (including deductibles, copayments, co-insurance rates and out-of-pocket maximums) to family members as to employees.

Corresponding IRS mid-year election change relief

The IRS simultaneously published Notice 2022-41, which adds a new optional permitted mid-year election change event for IRC Section 125 cafeteria plans (also known as a qualifying life event or QLE). The intent of this QLE is to allow employees to drop medical coverage for family members who gain access to subsidized Marketplace coverage and avoid periods of dual or no coverage.

The existing cafeteria plan regulations allow employers to adopt a QLE permitting mid-year election changes to revoke medical coverage due to Marketplace open or special enrollment. However, the existing Marketplace QLE only applies if the employee also drops coverage and enrolls in the Marketplace.

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[5] In general, insurance carriers will calculate MV for a fully insured medical plan. TPAs may calculate MV for self-insured coverage, or an employer may do this with support from its broker, consulting firm, and/or actuary. CMS provide resources, including a calculator, to help plans make MV determinations.

[6] MV will continue to be calculated looking at benefits provided to the standard population, including both employees and their family members.

[7] Most third parties use the CMS calculator for MV testing, which does not currently evaluate family coverage. The preamble to the regulations suggest HHS will review the calculator to determine what updates are needed to address these changes for the new rules. In the meantime, the potential wrinkle described in this Alert should rarely be an issue.

In Notice 2022-41, the IRS added a new Marketplace QLE to account for the fix to the family glitch. The new QLE will now permit employers to amend their cafeteria plans to permit employees to drop medical coverage for any family member if:

- The family member enrolls or intends to enroll in Marketplace coverage during a Marketplace special or annual open enrollment period[8]; and

- The Marketplace coverage is effective no later than the day after the family member's coverage under the employer medical plan ends.

This change means the employee no longer has to drop medical coverage and enroll in the Marketplace as well. This relief only applies to elections effective on or after January 1, 2023. It is important to understand this relief is optional. If an employer wants to adopt it, we recommend the employer consider amending its cafeteria plan by specific reference to this Marketplace QLE.[9]

An employer has until the end of its cafeteria plan year beginning in 2024 to amend its cafeteria plan to allow election changes for this QLE retroactive to the beginning of its 2023 plan year. For example, an employer with a calendar year cafeteria plan has until December 31, 2024 to amend its cafeteria plan to allow these election changes retroactive to the 2023 plan year. In later years, an employer must amend its cafeteria plan to adopt the Marketplace QLE no later than the last day of the plan year in which it will allow the corresponding election changes.

An employer can permit election changes prior to amending the plan so long as it communicates the availability of the Marketplace QLE for family members in advance and administers the plan accordingly.

The IRS quietly makes a significant change to the Marketplace QLE

The IRS initially published Notice 2022-41 on October 11, 2022. As drafted, the new Marketplace QLE only applied to non-calendar year cafeteria plans. The IRS appeared to take the position that calendar year plans did not need this QLE since employees could drop family member coverage at open enrollment and both the employer plan and Marketplace coverage operated on the same plan year.

Sometime around November 7, 2022, the IRS revised Notice 2022-41 without announcement. While the Notice's "Background" section still focuses on the need for the new QLE for non-calendar year plans, the "Guidance" section no longer limits this QLE to non-calendar year plans. We will provide excerpts from the two versions below.

Excerpt from initial Notice 2022-41 (underlining ours for emphasis)

> "GUIDANCE
>
> In addition to the situations described in Notice 2014-55, <u>a non-calendar year cafeteria plan</u> may allow an employee to revoke prospectively an election of family coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in section 5000A(f)(1)) provided the following conditions are satisfied:"
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> [rest omitted]

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[8] Gaining eligibility for a Marketplace PTC is a Marketplace special enrollment event. The employer does not have to require proof of enrollment in Marketplace coverage and can rely on an employee's reasonable representation that enrollment has or will occur.

[9] Due to a technicality, we do not believe it is sufficient to attempt to incorporate the Marketplace QLEs solely by reference to the permitted election changes described in Treasury Regulation §1.125-4 (the cafeteria plan QLE regulations). Although the IRS intends to amend the regulations to include them, they do not actually exist in the text of the regulations today and instead appear only in IRS Notices.

Excerpt from revised Notice 2022-41 (underlining ours for emphasis)

> "GUIDANCE
>
> In addition to the situations described in Notice 2014-55, a cafeteria plan may allow an employee to revoke prospectively an election of family coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in section 5000A(f)(1)) provided the following conditions are satisfied:"
>
> [rest omitted]

As written, the revised Notice 2022-41 allows all cafeteria plans to adopt the new Marketplace QLE.

Minimal employer impact

The fix to the family glitch has little direct or indirect impact to employers and no negative effect on them. The change to the subsidy rules for family members has no effect on employers for ACA purposes. The preamble to the final regulations specifically states in multiple locations that:

- There is no change to ACA affordability determinations or 4980H penalty risk with respect to offers of coverage to full-time employees, and the same affordability safe harbors apply.
- There is no change to ACA reporting obligations (i.e. Forms 1094/1095).
- There is no new employer disclosure requirement, although employers may communicate the changes to their employees and dependents, if they wish.[10]

The rules appear to provide employers with two new strategic options:

1. Employers can choose whether to adopt the new Marketplace QLE and allow employees to drop coverage for family members mid-year when a family member gains access to the Marketplace through a Marketplace special or annual open enrollment period.
2. Employers can choose to alter their contribution strategies to make medical coverage for spouses and/or dependents unaffordable for the purposes of the family members qualifying for Marketplace PTCs and employees potentially dropping them from the employer's coverage. This strategy may be attractive for some employers and unattractive for others. Employers adopting this strategy may be more likely to adopt the new Marketplace QLE.

Beware: Although the family glitch fix does not increase ACA penalty risk for ALEs, the expanded subsidy eligibility provisions under the American Rescue Plan Act of 2021 (ARPA) in effect through 2025, significantly increases the likelihood that FT employees are eligible for Marketplace subsidies, and will enroll in Marketplace coverage. We addressed this risk in in a prior alert.

[10] The IRS intends to release new resources, at some future date, explaining the new rules that employers *may* use.

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