may be on a pre-tax basis. A cafeteria plan must, as required by FMLA, permit an employee whose coverage terminated while on FMLA leave (either by revocation or nonpayment of premiums) to be reinstated in the cafeteria plan on return from FMLA leave. See 29 CFR 825.214(a) and 825.215(d).

Q–8: What is the applicability date of the regulations in this section?

A–8: This section is applicable for cafeteria plan years beginning on or after January 1, 2002.

[T.D. 8966, 66 FR 52677, Oct. 17, 2001; 66 FR 63920, Dec. 11, 2001]

§ 1.125–4 Permitted election changes.

(a) *Election changes.* A cafeteria plan may permit an employee to revoke an election during a period of coverage and to make a new election only as provided in paragraphs (b) through (g) of this section. Section 125 does not require a cafeteria plan to permit any of these changes. See paragraph (h) of this section for special provisions relating to qualified cash or deferred arrangements, and paragraph (i) of this section for special definitions used in this section.

(b) *Special enrollment rights*—(1) *In general.* A cafeteria plan may permit an employee to revoke an election for coverage under a group health plan during a period of coverage and make a new election that corresponds with the special enrollment rights provided in section 9801(f).

(2) *Examples.* The following examples illustrate the application of this paragraph (b):

Example 1. (i) Employer *M* provides health coverage for its employees pursuant to a plan that is subject to section 9801(f). Under the plan, employees may elect either employee-only coverage or family coverage. *M* also maintains a calendar year cafeteria plan under which qualified benefits, including health coverage, are funded through salary reduction. *M*'s employee, *A*, is married to *B* and they have a child, *C*. In accordance with *M*'s cafeteria plan, Employee *A* elects employee-only health coverage before the beginning of the calendar year. During the year, *A* and *B* adopt a child, *D*. Within 30 days thereafter, *A* wants to revoke *A*'s election for employee-only health coverage and obtain family health coverage for *A*'s spouse, *C*, and *D* as of the date of *D*'s adoption. Employee *A* satisfies the conditions for special enrollment of an employee with a new dependent under section 9801(f)(2), so that *A* may enroll in family coverage under *M*'s accident or health plan in order to provide coverage effective as of the date of *D*'s adoption.

(ii) *M*'s cafeteria plan may permit *A* to change *A*'s salary reduction election to family coverage for salary not yet currently available. The increased salary reduction is permitted to reflect the cost of family coverage from the date of adoption. (*A*'s adoption of *D* is also a change in status, and the election of family coverage is consistent with that change in status. Thus, under paragraph (c) of this section, *M*'s cafeteria plan could permit *A* to elect family coverage prospectively in order to cover *B*, *C*, and *D* for the remaining portion of the period of coverage.)

Example 2. (i) The employer plans and permissible coverage are the same as in *Example 1*. Before the beginning of the calendar year, Employee *E* elects employee-only health coverage under *M*'s cafeteria plan. Employee *E* marries *F* during the plan year. *F*'s employer, *N*, offers health coverage to *N*'s employees, and, prior to the marriage, *F* had elected employee-only coverage. Employee *E* wants to revoke the election for employee-only coverage under *M*'s cafeteria plan, and is considering electing family health coverage under *M*'s plan or obtaining family health coverage under *N*'s plan.

(ii) *M*'s cafeteria plan may permit *E* to change *E*'s salary reduction election to reflect the change to family coverage under *M*'s accident or health plan because the marriage would result in special enrollment rights under section 9801(f), pursuant to which an election of family coverage under *M*'s accident or health plan would be required to be effective no later than the first day of the first calendar month beginning after the completed request for enrollment is received by the plan. Since no retroactive coverage is required in the event of marriage under section 9801(f), *E*'s salary reduction election may only be changed on a prospective basis. (*E*'s marriage to *F* is also a change in status under paragraph (c) of this section, as illustrated in Example 1 of paragraph (c)(4) of this section.)

(c) *Changes in status*—(1) *Change in status rule.* A cafeteria plan may permit an employee to revoke an election during a period of coverage with respect to a qualified benefits plan (defined in paragraph (i)(8) of this section) to which this paragraph (c) applies and make a new election for the remaining portion of the period (referred to in this section as an election change) if, under the facts and circumstances—

(i) A change in status described in paragraph (c)(2) of this section occurs; and

(ii) The election change satisfies the consistency rule of paragraph (c)(3) of this section.

(2) *Change in status events.* The following events are changes in status for purposes of this paragraph (c):

(i) *Legal marital status.* Events that change an employee's legal marital status, including the following: marriage; death of spouse; divorce; legal separation; and annulment.

(ii) *Number of dependents.* Events that change an employee's number of dependents, including the following: birth; death; adoption; and placement for adoption.

(iii) *Employment status.* Any of the following events that change the employment status of the employee, the employee's spouse, or the employee's dependent: 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 cafeteria plan or other employee 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 that the individual becomes (or ceases to be) eligible under the plan, then that change constitutes a change in employment under this paragraph (c) (*e.g.*, if a plan only applies to salaried employees and an employee switches from salaried to hourly-paid with the consequence that the employee ceases to be eligible for the plan, then that change constitutes a change in employment status under this paragraph (c)(2)(iii)).

(iv) *Dependent satisfies or ceases to satisfy eligibility requirements.* Events that cause an employee's dependent to satisfy or cease to satisfy eligibility requirements for coverage on account of attainment of age, student status, or any similar circumstance.

(v) *Residence.* A change in the place of residence of the employee, spouse, or dependent.

(vi) *Adoption assistance.* For purposes of adoption assistance provided through a cafeteria plan, the commencement or termination of an adoption proceeding.

(3) *Consistency rule*—(i) *Application to accident or health coverage and group-term life insurance.* An election change satisfies the requirements of this paragraph (c)(3) with respect to accident or health coverage or group-term life insurance only if the election change is on account of and corresponds with a change in status that affects eligibility for coverage under an employer's plan. A change in status that affects eligibility under an employer's plan includes a change in status that results in an increase or decrease in the number of an employee's family members or dependents who may benefit from coverage under the plan.

(ii) *Application to other qualified benefits.* An election change satisfies the requirements of this paragraph (c)(3) with respect to other qualified benefits if the election change is on account of and corresponds with a change in status that affects eligibility for coverage under an employer's plan. An election change also satisfies the requirements of this paragraph (c)(3) if the election change is on account of and corresponds with a change in status that effects expenses described in section 129 (including employment-related expenses as defined in section 21(b)(2)) with respect to dependent care assistance, or expenses described in section 137 (including qualified adoption expenses as defined in section 137(d)) with respect to adoption assistance.

(iii) *Application of consistency rule.* 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, an employee's election under the cafeteria plan to cancel accident or health insurance coverage for any individual other than the spouse involved in the divorce, annulment or legal separation, the deceased spouse or dependent, or the dependent that ceased to satisfy the eligibility requirements for coverage, respectively, fails to correspond with that change in status. 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. In addition, if an employee, spouse, or dependent gains eligibility for coverage under a family member plan (as defined in paragraph (i)(5) of this section) as a result of a change in marital status under paragraph (c)(2)(i) of this section or a change in employment status under paragraph (c)(2)(iii) of this section, an employee's election under the cafeteria plan to cease or decrease coverage for that individual under the cafeteria plan corresponds with that change in status only if coverage for that individual becomes applicable or is increased under the family member plan. With respect to group-term life insurance and disability coverage (as defined in paragraph (i)(4) of this section), an election under a cafeteria plan to increase coverage (or an election to decrease coverage) in response to a change in status described in paragraph (c)(2) of this section is deemed to correspond with that change in status as required by paragraph (c)(3)(i) of this section.

(iv) *Exception for COBRA*. If the employee, spouse, or dependent becomes eligible for continuation coverage under the group health plan of the employee's employer as provided in section 4980B or any similar state law, a cafeteria plan may permit the employee to elect to increase payments under the employer's cafeteria plan in order to pay for the continuation coverage.

(4) *Examples*. The following examples illustrate the application of this paragraph (c):

Example 1. (i) Employer *M* provides health coverage (including a health FSA) for its employees through its cafeteria plan. Before the beginning of the calendar year, Employee *A* elects employee-only health coverage under *M*'s cafeteria plan and elects salary reduction contributions to fund coverage under the health FSA. Employee *A* marries *B* during the year. Employee *B*'s employer, *N*, offers health coverage to *N*'s employees (but not including any health FSA), and, prior to the marriage, *B* had elected employee-only coverage. Employee *A* wants to revoke the election for employee-only coverage, and is considering electing family health coverage under *M*'s plan or obtaining family health coverage under *N*'s plan.

(ii) Employee *A*'s marriage to *B* is a change in status under paragraph (c)(2)(i) of this section, pursuant to which *B* has become eligible for coverage under *M*'s health plan under paragraph (c)(3)(i) of this section. Two possible election changes by *A* correspond with the change in status: Employee *A* may elect family health coverage under *M*'s plan to cover *A* and *B*; or *A* may cancel coverage under *M*'s plan, if *B* elects family health coverage under *N*'s plan to cover *A* and *B*. Thus, *M*'s cafeteria plan may permit *A* to make either election change.

(iii) Employee *A* may also increase salary reduction contributions to fund coverage for *B* under the health FSA.

Example 2. (i) Employee *C*, a single parent, elects family health coverage under a calendar year cafeteria plan maintained by Employer *O*. Employee *C* and *C*'s 21-year old child, *D*, are covered under *O*'s health plan. During the year, *D* graduates from college. Under the terms of the health plan, dependents over the age of 19 must be full-time students to receive coverage. Employee *C* wants to revoke *C*'s election for family health coverage and obtain employee-only coverage under *O*'s cafeteria plan.

(ii) *D*'s loss of eligibility for coverage under the terms of the health plan is a change in status under paragraph (c)(2)(iv) of this section. A revocation of *C*'s election for family coverage and new election for employee-only coverage corresponds with the change in status. Thus, *O*'s cafeteria plan may permit *C* to elect employee-only coverage.

Example 3. (i) Employee *E* is married to *F* and they have one child, *G*. Employee *E* is employed by Employer *P*, and *P* maintains a calendar year cafeteria plan that allows employees to elect no health coverage, employee-only coverage, employee-plus-one-dependent coverage, or family coverage. Under the plan, before the beginning of the calendar year, *E* elects family health coverage for *E*, *F*, and *G*. *E* and *F* divorce during the year and *F* loses eligibility for coverage under *P*'s plan. *G* does not lose eligibility for health coverage under *P*'s plan upon the divorce. *E* now wants to revoke *E*'s election under the cafeteria plan and elect no coverage.

(ii) The divorce is a change in status under paragraph (c)(2)(i). A change in the cafeteria plan election to cancel health coverage for *F* is consistent with that change in status. However, an election change to cancel *E*'s or *G*'s health coverage does not satisfy the consistency rule under paragraph (c)(3)(iii) of this section regarding cancellation of coverage for an employee's other dependents in the event of divorce. Therefore, the cafeteria plan may not permit *E* to elect no coverage. However, an election to change to employee-plus-one-dependent health coverage would correspond with the change in status, and thus the cafeteria plan may permit *E* to elect employee-plus-one-dependent health coverage.

(iii) In addition, under paragraph (f)(4) of this section, if *F* makes an election change to cover *G* under *F*'s employer's plan, then *E* may make a corresponding change to elect employee-only coverage under *P*'s cafeteria plan.

Example 4. (i) Employer *R* maintains a calendar year cafeteria plan under which full-time employees may elect coverage under one of three benefit package options provided under an accident or health plan: an indemnity option or either of two HMO options for employees who work in the respective service areas of the two HMOs. Employee *A*, who works in the service area of HMO #1, elects the HMO #1 option. During the year, *A* is transferred to another work location which is outside the HMO #1 service area and inside the HMO #2 service area.

(ii) The transfer is a change in status under paragraph (c)(2)(iii) of this section (relating to a change in worksite), and, under the consistency rule in paragraph (c)(3) of this section, the cafeteria plan may permit *A* to make an election change to elect the indemnity option or HMO #2 or to cancel accident or health coverage.

(iii) The change in work location has no effect on *A*'s eligibility under R's health FSA, so no change in *A's* health FSA is authorized under this paragraph (c).

Example 5. (i) Employer *S* maintains a calendar year cafeteria plan that allows employees to elect coverage under an accident or health plan providing indemnity coverage and coverage under a health FSA. Prior to the beginning of the calendar year, Employee *B* elects employee-only indemnity coverage, and elects salary reduction contributions of $600 during the year to fund coverage under the health FSA for up to $600 of reimbursements for the year. Employee *B*'s spouse, *C*, has employee-only coverage under an accident or health plan maintained by *C*'s employer. During the year, *C* terminates employment and loses coverage under that plan. *B* now wants to elect family coverage under *S*'s accident or health plan and increase *B*'s FSA election.

(ii) *C*'s termination of employment is a change in status under paragraph (c)(2)(iii) of this section, and the election change satisfies the consistency rule of paragraph (c)(3) of this section. Therefore, the cafeteria plan may permit *B* to elect family coverage under *S*'s accident or health plan and to increase *B*'s FSA coverage.

Example 6. (i) Employer *T* provides group-term life insurance coverage as described under section 79. Under *T*'s plan, an employee may elect life insurance coverage in an amount up to $50,000. *T* also maintains a calendar year cafeteria plan under which qualified benefits, including the group-term life insurance coverage, are funded through salary reduction. Employee *D* has a spouse and a child. Before the beginning of the year, *D* elects $10,000 of group-term life insurance coverage. During the year, *D* is divorced.

(ii) The divorce is a change in status under paragraph (c)(2)(i) of this section. Under paragraph (c)(3)(iii) of this section, either an increase or a decrease in coverage is consistent with this change in status. Thus, *T*'s cafeteria plan may permit *D* to increase or to decrease *D*'s group-term life insurance coverage.

Example 7. (i) Employee *E* is married to F and they have one child, *G*. Employee *E*'s employer, *U*, maintains a cafeteria plan under which employees may elect no coverage, employee-only coverage, or family coverage under a group health plan maintained by *U*, and may make a separate vision coverage election under the plan. Before the beginning of the calendar year, *E* elects family health coverage and no vision coverage under *U*'s cafeteria plan. Employee *F*'s employer, *V*, maintains a cafeteria plan under which employees may elect no coverage, employee-only coverage, or family coverage under a group health plan maintained by *V*, and may make a separate vision coverage election under the plan. Before the beginning of the calendar year, *F* elects no health coverage and employee-only vision coverage under *V*'s plan. During the year, *F* terminates employment with *V* and loses vision coverage under *V*'s plan. Employee *E* now wants to elect family vision coverage under *U*'s group health plan.

(ii) *F*'s termination of employment is a change in status under paragraph (c)(2)(iii) of this section, and the election change satisfies the consistency rule of paragraph (c)(3) of this section. Therefore, *U*'s cafeteria plan may permit *E* to elect family vision coverage (covering *E* and *G* as well as *F*) under *U*'s group health plan.

Example 8. (i) Before the beginning of the year, Employee *H* elects to participate in a cafeteria plan maintained by *H*'s employer, *W*. However, in order to change the election during the year so as to cancel coverage, and by prior understanding with *W*, *H* terminates employment and resumes employment one week later.

(ii) In this *Example 8*, under the facts and circumstances, a principal purpose of the termination of employment was to alter the election, and reinstatement of employment was understood at the time of termination. Accordingly, *H* does not have a change in status under paragraph (c)(2)(iii) of this section.

(iii) However, *H*'s termination of employment would constitute a change in status, permitting a cancellation of coverage during the period of unemployment, if *H*'s original cafeteria plan election for the period of coverage was reinstated upon resumption of employment (for example, if *W*'s cafeteria plan contains a provision requiring an employee who resumes employment within 30 days, without any other intervening event that would permit a change in election, to return to the election in effect prior to termination of employment).

(iv) If, instead, *H* terminates employment and cancels coverage during a period of unemployment, and then returns to work more than 30 days following termination of employment, the cafeteria plan may permit *H* the option of returning to the election in effect prior to termination of employment or making a new election under the plan. Alternatively, the cafeteria plan may prohibit *H* from returning to the plan during that plan year.

Example 9. (i) Employee *A* has one child, *B*. Employee *A*'s employer, *X*, maintains a calendar year cafeteria plan that allows employees to elect coverage under a dependent care FSA. Prior to the beginning of the calendar year, *A* elects salary reduction contributions of $4,000 during the year to fund coverage under the dependent care FSA for up to $4,000 of reimbursements for the year. During the year, *B* reaches the age of 13, and *A* wants to cancel coverage under the dependent care FSA.

(ii) When *B* turns 13, *B* ceases to satisfy the definition of qualifying individual under section 21(b)(1) of the Internal Revenue Code. Accordingly, *B*'s attainment of age 13 is a change in status under paragraph (c)(2)(iv) of this section that affects *A*'s employment-related expenses as defined in section 21(b)(2). Therefore, *A* may make a corresponding change under *X*'s cafeteria plan to cancel coverage under the dependent care FSA.

Example 10. (i) Employer *Y* maintains a calendar year cafeteria plan under which full-time employees may elect coverage under either an indemnity option or an HMO. Employee *C* elects the employee-only indemnity option. During the year, *C* marries *D*. *D* has two children from a previous marriage, and has family group health coverage in a cafeteria plan sponsored by *D*'s employer, *Z*. *C* wishes to change from employee-only indemnity coverage to HMO coverage for the family. *D* wishes to cease coverage in *Z*'s group health plan and certifies to *Z* that *D* will have family coverage under *C*'s plan (and *Z* has no reason to believe the certification is incorrect).

(ii) The marriage is a change in status under paragraph (c)(2)(i) of this section. Under the consistency rule in paragraph (c)(3) of this section, *Y*'s cafeteria plan may permit *C* to change his or her salary reduction contributions to reflect the change from employee-only indemnity to HMO family coverage, and *Z* may permit *D* to revoke coverage under *Z*'s cafeteria plan.

(d) *Judgment, decree, or order*—(1) *Conforming election change.* This paragraph (d) applies to a judgment, decree, or order (order) resulting from a divorce, legal separation, annulment, or change in legal custody (including a qualified medical child support order as defined in section 609 of the Employee Retirement Income Security Act of 1974 (Public Law 93–406 (88 Stat. 829))) that requires accident or health coverage for an employee's child or for a foster child who is a dependent of the employee. A cafeteria plan will not fail to satisfy section 125 if it—

(i) Changes the employee's election to provide coverage for the child if the order requires coverage for the child under the employee's plan; or

(ii) Permits the employee to make an election change to cancel coverage for the child if:

(A) The order requires the spouse, former spouse, or other individual to provide coverage for the child; and

(B) That coverage is, in fact, provided.

(2) *Example.* The following example illustrates the application of this paragraph (d):

Example. (i) Employer *M* maintains a calendar year cafeteria plan that allows employees to elect no health coverage, employee-only coverage, employee-plus-one-dependent coverage, or family coverage. *M*'s employee, *A*, is married to *B* and they have one child, *C*. Before the beginning of the year, *A* elects employee-only health coverage. Employee *A* divorces *B* during the year and, pursuant to *A*'s divorce agreement with *B*, *M*'s health plan receives a qualified medical child support order (as defined in section 609 of the Employee Retirement Income Security Act of 1974) during the plan year. The order requires *M*'s health plan to cover *C*.

(ii) Under this paragraph (d), *M*'s cafeteria plan may change *A*'s election from employee-only health coverage to employee-plus-one-dependent coverage in order to cover *C*.

(e) *Entitlement to Medicare or Medicaid.* If an employee, spouse, or dependent who is enrolled in an accident or health plan of the employer becomes entitled to coverage (i.e., becomes enrolled) under Part A or Part B of Title XVIII of the Social Security Act (Medicare) (Public Law 89–97 (79 Stat. 291)) or Title XIX of the Social Security Act (Medicaid) (Public Law 89–97 (79 Stat.

343)), other than coverage consisting solely of benefits under section 1928 of the Social Security Act (the program for distribution of pediatric vaccines), a cafeteria plan may permit the employee to make a prospective election change to cancel or reduce coverage of that employee, spouse, or dependent under the accident or health plan. In addition, if an employee, spouse, or dependent who has been entitled to such coverage under Medicare or Medicaid loses eligibility for such coverage, the cafeteria plan may permit the employee to make a prospective election to commence or increase coverage of that employee, spouse, or dependent under the accident or health plan.

(f) *Significant cost or coverage changes*—(1) *In general*. Paragraphs (f)(2) through (5) of this section set forth rules for election changes as a result of changes in cost or coverage. This paragraph (f) does not apply to an election change with respect to a health FSA (or on account of a change in cost or coverage under a health FSA).

(2) *Cost changes*—(i) *Automatic changes*. If the cost of a qualified benefits plan increases (or 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 increase (or decrease) in affected employees' elective contributions for the plan.

(ii) *Significant cost changes*. If the cost charged to an employee for a benefit package option (as defined in paragraph (i)(2) of this section) significantly increases or significantly decreases during a period of coverage, the cafeteria plan may permit the employee to make a corresponding change in election under the cafeteria plan. Changes that may be made include commencing participation in the cafeteria plan for the option with a decrease in cost, or, in the case of an increase in cost, revoking an election for that coverage and, in lieu thereof, either receiving on a prospective basis coverage under another benefit package option providing similar coverage or dropping coverage if no other benefit package option providing similar coverage is available. For example, if the cost of an indemnity option under an accident or health plan significantly increases during a period of coverage, employees who are covered by the indemnity option may make a corresponding prospective increase in their payments or may instead elect to revoke their election for the indemnity option and, in lieu thereof, elect coverage under another benefit package option including an HMO option (or drop coverage under the accident or health plan if no other benefit package option is offered).

(iii) *Application of cost changes*. For purposes of paragraphs (f)(2)(i) and (ii) of this section, a cost increase or decrease refers to an increase or decrease in the amount of the elective contributions under the cafeteria plan, whether that increase or decrease results from an action taken by the employee (such as switching between full-time and part-time status) or from an action taken by an employer (such as reducing the amount of employer contributions for a class of employees).

(iv) *Application to dependent care*. This paragraph (f)(2) applies in the case of a dependent care assistance plan only if the cost change is imposed by a dependent care provider who is not a relative of the employee. For this purpose, a relative is an individual who is related as described in section 152(a)(1) through (8), incorporating the rules of section 152(b)(1) and (2).

(3) *Coverage changes*—(i) *Significant curtailment without loss of coverage*. If an employee (or an employee's spouse or dependent) has a significant curtailment of coverage under a plan during a period of coverage that is not a loss of coverage as described in paragraph (f)(3)(ii) of this section (for example, there is a significant increase in the deductible, the copay, or the out-of-pocket cost sharing limit under an accident or health plan), the cafeteria plan may permit any employee who had been participating in the plan and receiving that coverage to revoke his or her election for that coverage and, in lieu thereof, to elect to receive on a prospective basis coverage under another benefit package option providing similar coverage. Coverage 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. Thus, in most cases, the loss of one particular physician in a network does not constitute a significant curtailment.

(ii) *Significant curtailment with loss of coverage.* If an employee (or the employee's spouse or dependent) has a significant curtailment that is a loss of coverage, the plan may permit that employee to revoke his or her election under the cafeteria plan and, in lieu thereof, to elect either to receive on a prospective basis coverage under another benefit package option providing similar coverage or to drop coverage if no similar benefit package option is available. For purposes of this paragraph (f)(3)(ii), a loss of coverage means a complete loss of coverage under the benefit package option or other coverage option (including the elimination of a benefits package option, an HMO ceasing to be available in the area where the individual resides, or the individual losing all coverage under the option by reason of an overall lifetime or annual limitation). In addition, the cafeteria plan may, in its discretion, treat the following as a loss of coverage—

(A) A substantial decrease in the medical care providers available under the option (such as a major hospital ceasing to be a member of a preferred provider network or a substantial decrease in the physicians participating in a preferred provider network or an HMO);

(B) A reduction in the benefits for a specific type of medical condition or treatment with respect to which the employee or the employee's spouse or dependent is currently in a course of treatment; or

(C) Any other similar fundamental loss of coverage.

(iii) *Addition or improvement of a benefit package option.* If a plan adds a new benefit package option or other coverage option, or if coverage under an existing benefit package option or other coverage option is significantly improved during a period of coverage, the cafeteria plan may permit eligible employees (whether or not they have previously made an election under the cafeteria plan or have previously elected the benefit package option) to revoke their election under the cafeteria plan and, in lieu thereof, to make an election on a prospective basis for coverage under the new or improved benefit package option.

(4) *Change in coverage under another employer plan.* A cafeteria plan may permit an employee to make a prospective election change that is on account of and corresponds with a change made under another employer plan (including a plan of the same employer or of another employer) if—

(i) The other cafeteria plan or qualified benefits plan permits participants to make an election change that would be permitted under paragraphs (b) through (g) of this section (disregarding this paragraph (f)(4)); or

(ii) The cafeteria plan permits participants to make an election for a period of coverage that is different from the period of coverage under the other cafeteria plan or qualified benefits plan.

(5) *Loss of coverage under other group health coverage.* A cafeteria plan may permit an employee to make an election on a prospective basis to add coverage under a cafeteria plan for the employee, spouse, or dependent if the employee, spouse, or dependent loses coverage under any group health coverage sponsored by a governmental or educational institution, including the following—

(i) A State's children's health insurance program (SCHIP) under Title XXI of the Social Security Act;

(ii) A medical care program of an Indian Tribal government (as defined in section 7701(a)(40)), the Indian Health Service, or a tribal organization;

(iii) A State health benefits risk pool; or

(iv) A Foreign government group health plan.

(6) *Examples.* The following examples illustrate the application of this paragraph (f):

Example 1. (i) A calendar year cafeteria plan is maintained pursuant to a collective bargaining agreement for the benefit of Employer *M*'s employees. The cafeteria plan offers various benefits, including indemnity health insurance and a health FSA. As a result of mid-year negotiations, premiums for the indemnity health insurance are reduced in the middle of the year, insurance co-payments for office visits are reduced under the indemnity plan by an amount which constitutes a significant benefit improvement, and an HMO option is added.

(ii) Under these facts, the reduction in health insurance premiums is a reduction in cost. Accordingly, under paragraph (f)(2)(i) of this section, the cafeteria plan may automatically decrease the amount of salary reduction contributions of affected participants by an amount that corresponds to the premium change. However, the plan may not permit employees to change their health FSA elections to reflect the mid-year change in copayments under the indemnity plan.

(iii) Also, the decrease in co-payments is a significant benefit improvement and the addition of the HMO option is an addition of a benefit package option. Accordingly, under paragraph (f)(3)(ii) of this section, the cafeteria plan may permit eligible employees to make an election change to elect the indemnity plan or the new HMO option. However, the plan may not permit employees to change their health FSA elections to reflect differences in co-payments under the HMO option.

Example 2. (i) Employer *N* sponsors an accident or health plan under which employees may elect either employee-only coverage or family health coverage. The 12-month period of coverage under *N*'s cafeteria plan begins January 1, 2001. *N*'s employee, *A*, is married to *B*. Employee *A* elects employee-only coverage under *N*'s plan. *B*'s employer, *O*, offers health coverage to *O*'s employees under its accident or health plan under which employees may elect either employee-only coverage or family coverage. *O*'s plan has a 12-month period of coverage beginning September 1, 2001. *B* maintains individual coverage under *O*'s plan at the time *A* elects coverage under *N*'s plan, and wants to elect no coverage for the plan year beginning on September 1, 2001, which is the next period of coverage under *O*'s accident or health plan. *A* certifies to *N* that *B* will elect no coverage under *O*'s accident or health plan for the plan year beginning on September 1, 2001 and *N* has no reason to believe that *A*'s certification is incorrect.

(ii) Under paragraph (f)(4)(ii) of this section, *N*'s cafeteria plan may permit *A* to change *A*'s election prospectively to family coverage under that plan effective September 1, 2001.

Example 3. (i) Employer *P* sponsors a calendar year cafeteria plan under which employees may elect either employee-only or family health coverage. Before the beginning of the year, *P*'s employee, *C*, elects family coverage under *P*'s cafeteria plan. *C* also elects coverage under the health FSA for up to $200 of reimbursements for the year to be funded by salary reduction contributions of $200 during the year. *C* is married to *D*, who is employed by Employer *Q*. *Q* does not maintain a cafeteria plan, but does maintain an accident or health plan providing its employees with employee-only coverage. During the calendar year, *Q* adds family coverage as an option under its health plan. *D* elects family coverage under *Q*'s plan, and *C* wants to revoke *C*'s election for health coverage and elect no health coverage under *P*'s cafeteria plan for the remainder of the year.

(ii) *Q*'s addition of family coverage as an option under its health plan constitutes a new coverage option described in paragraph (f)(3)(ii) of this section. Accordingly, pursuant to paragraph (f)(4)(i) of this section, *P*'s cafeteria plan may permit *C* to revoke *C*'s health coverage election if *D* actually elects family health coverage under *Q*'s accident or health plan. Employer *P*'s plan may not permit *C* to change *C*'s health FSA election.

Example 4. (i) Employer *R* maintains a cafeteria plan under which employees may elect accident or health coverage under either an indemnity plan or an HMO. Before the beginning of the year, *R*'s employee, *E* elects coverage under the HMO at a premium cost of $100 per month. During the year, *E* decides to switch to the indemnity plan, which charges a premium of $140 per month.

(ii) *E*'s change from the HMO to indemnity plan is not a change in cost or coverage under this paragraph (f), and none of the other election change rules under paragraphs (b) through (e) of this section apply.

(iii) Although *R*'s health plan may permit *E* to make the change from the HMO to the indemnity plan, *R*'s cafeteria plan may not permit *E* to make an election change to reflect the increased premium. Accordingly, if *E* switches from the HMO to the indemnity plan, *E* may pay the $40 per month additional cost on an after-tax basis.

Example 5. (i) Employee *A* is married to Employee *B* and they have one child, *C*. Employee *A*'s employer, *M*, maintains a calendar year cafeteria plan that allows employees to elect coverage under a dependent care FSA. Child *C* attends *X*'s on site child care center at an annual cost of $3,000. Prior to the beginning of the year, *A* elects salary reduction contributions of $3,000 during the year to fund coverage under the dependent care FSA for up to $3,000 of reimbursements for the year. Employee *A* now wants to revoke *A*'s election of coverage under the dependent care FSA, because *A* has found a new child care provider.

(ii) The availability of dependent care services from the new child care provider (whether the new provider is a household employee or family member of *A* or *B* or a person who is independent of *A* and *B*) is a significant change in coverage similar to a benefit package option becoming available. Because the

FSA is a dependent care FSA rather than a health FSA, the coverage rules of this section apply and *M*'s cafeteria plan may permit *A* to elect to revoke *A*'s previous election of coverage under the dependent care FSA, and make a corresponding new election to reflect the cost of the new child care provider.

Example 6. (i) Employee *D* is married to Employee *E* and they have one child, *F*. Employee *D*'s employer, *N*, maintains a calendar year cafeteria plan that allows employees to elect coverage under a dependent care FSA. Child *F* is cared for by *Y*, *D*'s household employee, who provides child care services five days a week from 9 a.m. to 6 p.m. at an annual cost in excess of $5,000. Prior to the beginning of the year, *D* elects salary reduction contributions of $5,000 during the year to fund coverage under the dependent care FSA for up to $5,000 of reimbursements for the year. During the year, *F* begins school and, as a result, *Y*'s regular hours of work are changed to five days a week from 3 p.m. to 6 p.m. Employee *D* now wants to revoke *D*'s election under the dependent care FSA, and make a new election under the dependent care FSA to an annual cost of $4,000 to reflect a reduced cost of child care due to *Y*'s reduced hours.

(ii) The change in the number of hours of work performed by *Y* is a change in coverage. Thus, *N*'s cafeteria plan may permit *D* to reduce *D*'s previous election under the dependent care FSA to $4,000.

Example 7. (i) Employee *G* is married to Employee *H* and they have one child, *J*. Employee *G*'s employer, *O*, maintains a calendar year cafeteria plan that allows employees to elect coverage under a dependent care FSA. Child *J* is cared for by *Z*, *G*'s household employee, who is not a relative of *G* and who provides child care services at an annual cost of $4,000. Prior to the beginning of the year, *G* elects salary reduction contributions of $4,000 during the year to fund coverage under the dependent care FSA for up to $4,000 of reimbursements for the year. During the year, *G* raises *Z*'s salary. Employee *G* now wants to revoke *G*'s election under the dependent care FSA, and make a new election under the dependent care FSA to an annual amount of $4,500 to reflect the raise.

(ii) The raise in *Z*'s salary is a significant increase in cost under paragraph (f)(2)(ii) of this section, and an increase in election to reflect the raise corresponds with that change in status. Thus, *O*'s cafeteria plan may permit *G* to elect to increase *G*'s election under the dependent care FSA.

Example 8. (i) Employer *P* maintains a calendar year cafeteria plan that allows employees to elect employee-only, employee plus one dependent, or family coverage under an indemnity plan. During the middle of the year, Employer *P* gives its employees the option to select employee-only or family coverage from an HMO plan. *P*'s employee, *J*, who had elected employee plus one dependent coverage under the indemnity plan, decides to switch to family coverage under the HMO plan.

(ii) Employer *P*'s midyear addition of the HMO option is an addition of a benefit package option. Under paragraph (f) of this section, Employee *J* may change his or her salary reduction contributions to reflect the change from indemnity to HMO coverage, and also to reflect the change from employee plus one dependent to family coverage (however, an election of employee-only coverage under the new option would not correspond with the addition of a new option). Employer *P* may not permit *J* to change *J*'s health FSA election.

(g) *Special requirements relating to the Family and Medical Leave Act*. An employee taking leave under the Family and Medical Leave Act (FMLA) (Public Law 103–3 (107 Stat. 6)) may revoke an existing election of accident or health plan coverage and make such other election for the remaining portion of the period of coverage as may be provided for under the FMLA. See §1.125–3 for additional rules.

(h) *Elective contributions under a qualified cash or deferred arrangement*. The provisions of this section do not apply with respect to elective contributions under a qualified cash or deferred arrangement (within the meaning of section 401(k)) or employee contributions subject to section 401(m). Thus, a cafeteria plan may permit an employee to modify or revoke elections in accordance with section 401(k) and (m) and the regulations thereunder.

(i) *Definitions*. Unless otherwise provided, the definitions in paragraphs (i)(1) though (8) of this section apply for purposes of this section.

(1) *Accident or health coverage*. Accident or health coverage means coverage under an accident or health plan as defined in regulations under section 105.

(2) *Benefit package option*. A benefit package option means a qualified benefit under section 125(f) that is offered under a cafeteria plan, or an option for coverage under an underlying accident or health plan (such as an indemnity option, an HMO option, or a PPO option under an accident or health plan).

(3) *Dependent*. A dependent means a dependent as defined in section 152, except that, for purposes of accident or health coverage, any child to whom

section 152(e) applies is treated as a dependent of both parents, and, for purposes of dependent care assistance provided through a cafeteria plan, a dependent means a qualifying individual (as defined in section 21(b)(1)) with respect to the employee.

(4) *Disability coverage.* Disability coverage means coverage under an accident or health plan that provides benefits due to personal injury or sickness, but does not reimburse expenses incurred for medical care (as defined in section 213(d)) of the employee or the employee's spouse and dependents. For purposes of this section, disability coverage includes payments described in section 105(c).

(5) *Family member plan.* A family member plan means a cafeteria plan or qualified benefit plan sponsored by the employer of the employee's spouse or the employee's dependent.

(6) *FSA, health FSA.* An FSA means a qualified benefits plan that is a flexible spending arrangement as defined in section 106(c)(2) . A health FSA means a health or accident plan that is an FSA.

(7) *Placement for adoption.* Placement for adoption means placement for adoption as defined in regulations under section 9801.

(8) *Qualified benefits plan.* A qualified benefits plan means an employee benefit plan governing the provision of one or more benefits that are qualified benefits under section 125(f). A plan does not fail to be a qualified benefits plan merely because it includes an FSA, assuming that the FSA meets the requirements of section 125 and the regulations thereunder.

(9) *Similar coverage.* Coverage for the same category of benefits for the same individuals (*e.g.,* family to family or single to single). For example, two plans that provide coverage for major medical are considered to be similar coverage. For purposes of this definition, a health FSA is not similar coverage with respect to an accident or health plan that is not a health FSA. A plan may treat coverage by another employer, such as a spouse's or dependent's employer, as similar coverage.

(j) *Effective date*—(1) *General rule.* Except as provided in paragraph (j)(2) of this section, this section is applicable for cafeteria plan years beginning on or after January 1, 2001.

(2) *Delayed effective date for certain provisions.* The following provisions are applicable for cafeteria plan years beginning on or after January 1, 2002: paragraph (c) of this section to the extent applicable to qualified benefits other than an accident or health plan or a group-term life insurance plan; paragraph (d)(1)(ii)(B) of this section (relating to a spouse, former spouse, or other individual obtaining accident or health coverage for an employee's child in response to a judgment, decree, or order); paragraph (f) of this section (rules for election changes as a result of cost or coverage changes); and paragraph (i)(9) of this section (defining similar coverage).

[T.D. 8878, 65 FR 15550, Mar. 23, 2000, as amended by T.D. 8921, 66 FR 1840, Jan. 10, 2001; T.D. 8921, 66 FR 13013, Mar. 2, 2001; T.D. 8966, 66 FR 52680, Oct. 17, 2001]

§ 1.125–4T Permitted election changes (temporary).

(a) *Election changes.* A cafeteria plan may permit an employee to revoke an election during a period of coverage and to make a new election only as provided in paragraphs (b) through (i) of this section. See paragraph (j) of this section for special provisions relating to qualified cash or deferred arrangements.

(b) *Special enrollment rights.* A cafeteria plan may permit an employee to revoke an election for accident or health coverage during a period of coverage and make a new election that corresponds with the special enrollment rights provided in section 9801(f), whether or not the change in election is permitted under paragraph (c) of this section.

(c) *Changes in status for accident or health coverage and group-term life.* (1) *In general.* A cafeteria plan may permit an employee to revoke an election for accident or health coverage or group-term life insurance coverage during a period of coverage and make a new election for the remaining portion of the period if, under the facts and circumstances—

(i) A change in status occurs; and

(ii) The election change satisfies the consistency requirement in paragraph