



Compliance Matters

The 30-Day Grace Period Election Myth

Myth:

An employee may change their pretax election if they do so within 30 days of when the election first becomes effective.

e.g. Peanut's Pro Shop has open enrollment from 11/1-11/15 and benefits become effective 1/1. Peanut's Pro Shop allows employees to make changes to their elections if made prior to 1/31.

Fact:

Although most carriers will allow insurance elections to be changed within 30 days, there is no 30-day grace period under Code §125 permitting a change to a pretax election. Once the period of coverage starts, elections are irrevocable and may not be changed during the plan year unless another permissible midyear change in status event as recognized by Code §125 occurs, permitting the change to a pretax election.

The IRS has informally indicated that when there is “clear and convincing evidence” a mistake has been made an employer may correct the mistake.

e.g. Peanut's Pro Shop discovers after open enrollment when auditing their first invoice in January that an administrative error occurred. Charlie elected employee only coverage on his enrollment form but he is showing enrolled in family coverage on the invoice.

However, when an employee changes their mind or it is unclear whether it was a genuine mistake (i.e. subjective vs. objective), there is no IRS guidance suggesting a change is permissible.

An employer permitting a change to an employee's unproven mistake, risks jeopardizing the tax qualified status of the entire plan, not just the employee whom which the change was made. In other words, according to the regulations, failure to follow the terms of the plan or otherwise failing to comply with the requirements of Code §125, the plan is not a cafeteria plan and employees' elections between taxable and nontaxable benefits will result in gross income to the employees.

If an employer can objectively determine an election mistake was made, in general, they may make a correction and put the employee back into the same position as if the mistake never occurred. However, a variety of federal and state laws are involved with correcting payroll errors, so employers are encouraged to consult with counsel to review the facts and circumstances to ensure compliance with the various regulations prior to taking any corrective action.