



Internal Revenue Service released guidance to allow temporary changes to section 125 cafeteria plans

Overview

The following general summary is provided to assist employers and plan sponsors with their research into the potential impacts of recent government actions. This is not legal advice, and the relief actions are complex. As always, we strongly encourage employers and plan sponsors to consult their legal or benefits counsel for conclusive guidance on how the actions apply in their circumstances.

On May 12, 2020, the Department of the Treasury (the Treasury) and the Internal Revenue Service (IRS) published two notices as part of ongoing relief efforts related to the Novel Coronavirus Disease (COVID-19). These notices offer guidance for employers to allow additional flexibility with respect to their section 125 cafeteria plans, Healthcare Flexible Spending Accounts (health FSAs) and Dependent Care Assistance Programs (DCAPs) during the 2020 calendar year.

- IRS Notice 2020-29¹ provides greater flexibility for cafeteria plans, health flexible spending arrangements (FSAs), and dependent care assistance programs (DCAPs) with respect to mid-year election changes, an extension of claim periods for plan participants through 2020, and clarifies previously released guidance² with respect to Health Savings Account (HSA)-qualified High Deductible Health Plans (HDHPs).
- IRS Notice 2020-33³ replaced the current \$500 carryover amount for health FSAs with an amount equal to 20 percent of the annual salary reduction limit (indexed for inflation) and clarified the rules regarding reimbursements of health care premiums by Individual Coverage Health Reimbursement Arrangements (ICHRAs). While the guidance issued in Notice 2020-29 is directly related to and designed “to assist with the nation’s response” to COVID-19, the guidance in Notice 2020-33 is not COVID-19 specific.

Notice 2020-29

Mid-Year Election Changes Under a § 125 Cafeteria Plan

Generally, cafeteria plan elections must be irrevocable and made before the first day of the plan year. Plans may allow for mid-year election changes following certain “change in status” events (e.g., termination of employment). Under this guidance, a cafeteria plan sponsor may – at its discretion – amend its cafeteria plans to permit employees to make certain mid-year election changes prospectively during the 2020 calendar year:

- Make a new election to participate in employer-sponsored health coverage if the employee initially declined to elect employer-sponsored health coverage.
- Revoke an existing election for employer-sponsored health insurance coverage and make a new election to enroll in different health coverage provided by that employer (including changing enrollment to add otherwise-eligible dependents to the coverage prospectively).

- Revoke an existing election for employer-sponsored health coverage, provided that the employee attests in writing that the employee is enrolled – or immediately will enroll – in other “comprehensive” health coverage not provided by the employer (optional model attestation language is included in the notice).
- Revoke an election, make a new election, or increase or decrease an election to a health FSA.
- Revoke an election, make a new election, or increase or decrease an election to a DCAP.

Employers are not required to provide these election changes and can determine which changes they will permit. The relief provided in Notice 2020-29 may be applied retroactively to periods prior to this guidance and on or after January 1, 2020 to address a cafeteria plan that – prior to the issuance of this guidance – permitted mid-year election changes that are otherwise consistent with the requirements of the notice.

Also, in determining the extent to which these election changes are permitted and applied, the Treasury and IRS note that an employer may wish to consider the potential for adverse selection and limit mid-year elections to instances in which an employee’s coverage will be increased or improved as a result of the election (e.g., by switching from self-only to family coverage). For health FSAs and DCAPs, employers are permitted to limit mid-year election changes to amounts no less than amounts already reimbursed.

Extended Claims Period for Health FSAs and DCAPs

Generally, any unused balances remaining in an employee’s health FSA or DCAP at the end of the plan year is forfeited by the plan participant (the “use-it-or-lose-it” rule). Health FSAs or DCAPs may provide a grace period immediately following the end of each plan year during which unused amounts at the end of the plan year may be used to reimburse eligible medical expenses incurred during the grace period (which cannot extend more than 2 months and 15 days [“2½ months”] beyond the end of the preceding plan year). Employers may amend their health FSAs or DCAPs to permit employees to apply the unused amounts in their health FSA or DCAP as of the end of a grace period ending in 2020 (e.g., March 15, 2020 for the 2019 calendar plan year) or plan year ending in 2020 to pay for reimbursable medical expenses incurred on or before December 31, 2020. The relief in Notice 2020-29 applies both to general purpose and limited-purpose health FSAs.

The extension of time for incurring claims is available both to cafeteria plans that have a grace period and plans that provide for a carryover (notwithstanding the general rule⁴ that health FSAs may not have both a carryover and a grace period). In other words, a health FSA that allows a carryover would also be permitted to amend the plan to extend the claims period to December 31, 2020. However, this additional flexibility would only benefit those plans ending on or after January 1, 2020 (i.e., a non-calendar plan year). For a health FSA with a non-calendar plan year (e.g., February 1, 2019 – January 31, 2020), a participant would be able to use any remaining amounts from the 2019 plan year as of January 31, 2020 to pay for reimbursable expenses through December 31, 2020, even amounts exceeding the otherwise-applicable \$500 carryover limit for the 2019 plan year.

Conversely, a calendar-year health FSA (e.g., January 1, 2019 - December 31, 2019) with a carryover would already allow participants to use up to \$500 through the end of December 31, 2020 irrespective of this guidance and would not gain any additional flexibility from the extended

claims period nor would the 2019 carryover dollars be increased by the provisions of Notice 2020-33 (see [below](#)).

However, an individual who has unused amounts remaining at the end of the plan year or grace period ending in 2020, and who is allowed the extended claims period per Notice 2020-29, will be ineligible to make HSA contributions during the extended period (except in the case of an HSA-compatible health FSA, e.g., a limited-purpose FSA). Thus, employers who have HDHPs and facilitate the opening and maintenance of employees' HSAs should exercise care to make sure their adoption of this extension does not adversely impact their employees' ability to contribute to their HSAs.

A similar claims period extension can be made available for DCAPs

Plan Amendments

Plan amendments that allow for these mid-year cafeteria plan election changes and the extension of the claims period must be adopted before December 31, 2021, and can be retroactive to January 1, 2020, provided that the plan is operated in accordance with Notice 2020-29. Plan sponsors must notify eligible employees of the changes made under these temporary rules.

COVID-19 Testing and Treatment for HSA-Compatible HDHPs

In the previously released Notice 2020-15, the guidance allows HDHPs to provide benefits associated with testing for and treatment of COVID-19 either without a deductible or with one that is below the otherwise required minimum annual deductible; therefore, an HDHP providing such care on a no- or low-cost basis will not fail to qualify as an HDHP. Consequently, employees' eligibility to make contributions to their HSAs will not be jeopardized, even if medical expenses related to COVID-19 testing or treatment are paid by the HDHP. Notice 2020-29 clarifies that this relief applies for expenses incurred on or after January 1, 2020 and clarifies what expenses are to be treated as COVID-19 testing and treatment, including "the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) and any items or services required to be covered with zero cost sharing under the Families First Act, as amended by the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

Telemedicine and HSA-Compatible HDHPs

Just as HSA-qualified health plans can provide benefits related to COVID-19 testing and treatment either without a deductible or with reduced or no-cost sharing without jeopardizing HSA eligibility, Section 3701 of the CARES Act expanded this to include all remote care service expenses (i.e., telehealth). Previously, plans that covered telemedicine prior to reaching the deductible disqualified HSA holders from making HSA contributions. This change, effective as of March 27, 2020 (the date of enactment) applies for plan years beginning on or before December 31, 2021. Notice 2020-29 provides that such services provided on or after January 1, 2020 will also be permitted in an HSA-compatible HDHP.

Notice 2020-33

Health FSA Carryover

Under existing guidance, an employer may elect to allow a health FSA to provide that unused amounts at the end of the plan year could be carried over to the following plan year, which was limited to \$500. In June 2019, President Trump issued Executive Order 13877 – "Improving Price and Quality Transparency in American Healthcare to Put Patients First,"⁵ which directed the Secretary of the Treasury – to the extent consistent with the law - to issue guidance that would

increase the amount that could be carried over at the end of the year for health FSAs. Notice 2020-33, issued in response to the executive order, provides that the \$500 carryover amount is increased to an amount equal to 20 percent of the maximum health FSA salary reduction contribution for that plan year. This amount is set under Internal Revenue Code § 125(i) (at \$2,500) and indexed for inflation (i.e., \$2,750 for 2020). Accordingly, the maximum carryover amount from a plan year beginning in 2020 to be carried over to the immediately subsequent plan year beginning in 2021 is \$550 (= \$2,750 * 20%).

Notice 2020-33 provides that – for an employer that wishes to allow this increased carryover amount – the plan must be amended. In general, this amendment must be adopted on or before the last day of the plan year from which amounts may be carried over and may be effective retroactively to the first day of the plan year (provided the plan operates in accordance with the guidance under Notice 2020-33 and informs all eligible employees of the carryover provision). For 2020, however, the change must be adopted by December 31, 2021 and can be retroactive to the 2020 plan year.

Unlike the provisions of Notice 2020-29, this guidance is not time-limited and will apply indefinitely.

ICHRAs

An ICHRA is designed to provide a means for employees to be reimbursed for premiums for health insurance coverage incurred after the beginning of the ICHRA's plan year. Notice 2020-33 provides clarification intended "to assist with the implementation of individual health reimbursement arrangements," which are HRAs under which employers may provide contributions to use to purchase coverage in the Health Insurance Marketplace or Medicare.

Notice 2020-33 provides that the ICHRA is permitted to treat health care premiums as incurred on (1) the first day of each month of coverage, (2) the first day of the period of coverage, or (3) the date the premium is paid. Therefore, payment of the premium for coverage made before the beginning of the plan year can be reimbursed if the insurance coverage starts during the plan year.

Conclusion

The additional flexibility with respect to cafeteria plan benefits is a welcome response to the ongoing economic and health impacts of the COVID-19 pandemic. While the guidance described above provides relief for 2020, we will continue to monitor these developments and remain abreast of future relief efforts for the current year and possibly through 2021. As noted above, the government's actions are complex, and we encourage employers and plan sponsors to consult their legal or benefits advisors for conclusive guidance on how the actions apply in their circumstances.

The information contained in this memo is not intended to be legal, accounting, or other professional advice. We assume no liability whatsoever in connection with its use, nor are these comments directed to specific situations.

1. <https://www.irs.gov/pub/irs-drop/n-20-29.pdf>
2. <https://www.irs.gov/pub/irs-drop/n-20-15.pdf>
3. <https://www.irs.gov/pub/irs-drop/n-20-23.pdf>
4. <https://www.irs.gov/pub/irs-drop/n-13-71.pdf>
5. <https://www.govinfo.gov/content/pkg/FR-2019-06-27/pdf/2019-13945.pdf>