

IRS Allows for Temporary Flexibility with Long-Awaited Guidance that Expands Mid-Year Election Change Opportunities for Cafeteria Plans

GISUE MEHDI AND BRIANA B. DESCH

JULY 2020

In response to the COVID-19 pandemic, the U.S. Department of Treasury and the Internal Revenue Service (IRS) issued Notice 2020-29 and Notice 2020-33 (the “Notices”) on May 12, 2020. Notice 2020-29 provides increased flexibility for participants to make mid-year health plan, health flexible spending account (“Health FSA”), and dependent care flexible spending account (“Dependent Care FSA”) election changes. Notice 2020-33 increases the carryover limit permitted for Health FSAs. This guidance is permissive, so employers are not required to make these plan changes.

Expanded Mid-Year Election Changes for Section 125 (“Cafeteria”) Plans

Generally, once a participant makes a cafeteria plan election, that election is “irrevocable” for the entire plan year unless the participant experiences a Treasury Regulation Section 1.125-4 “permitted life event” (e.g., marriage, divorce, birth, etc.), which allows the participant to make certain plan changes that are consistent with that event.

As a result of the COVID-19 pandemic, employees may have experienced unanticipated changes to their health plan and childcare needs. Other employees may have put elective medical visits and procedures on hold during the pandemic and, therefore, have not incurred expenses under their Health FSAs. Generally, these COVID-19–related health plan changes in participant circumstances did not fall into any of the permitted life event categories, so employees were stuck with their pre-COVID-19 plan elections.



Accordingly, to address these unexpected circumstances, Notice 2020-29 permits employers to amend their cafeteria plans to allow for the following prospective mid-year election changes.

Mid-year enrollment in employer sponsored medical, dental, or vision coverage.

- 1) An employer, in its discretion, may amend its Internal Revenue Code Section 125 Plan ("Section 125 Plan") to allow employees who previously waived employer sponsored medical, dental, and/or vision plan coverage the opportunity to elect employer sponsored medical, dental, and/or vision plan coverage on a prospective basis, for the remainder of the 2020 calendar year.

Change plan options or add dependents.

- 2) An employer, in its discretion, may amend its Section 125 Plan to allow an employee to revoke his or her existing election for employer sponsored health coverage and to make a new election to enroll in different health coverage sponsored by the employer (e.g., changing from an HMO to a PPO plan, or changing enrollment from self-only coverage to family coverage).

Revoke health plan coverage.

- 3) An employer, in its discretion, may amend its Section 125 Plan to allow an employee to revoke an existing election for employer sponsored health coverage on a prospective basis, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer.¹ There is a model attestation form provided in Notice 2020-29 for employees who want to drop coverage.

Note: This permissive guidance does not require employers to provide unlimited election changes. An employer may determine the extent to which the election changes above are permitted and applied (provided that the employer considers any nondiscrimination concerns). For example, an employer may wish to limit the potential for adverse selection of health coverage by employees. To prevent adverse selection of health coverage, an employer may choose to only permit employees to make election changes that will result in increased or improved coverage (e.g., by only allowing election changes from self-only coverage to family coverage, or from a low option plan covering in-network expenses only to a high option plan covering expenses in and out of network).

Ultimately, the employer has flexibility in its approach to offer these expanded mid-year election change opportunities.

Flexible spending account election changes.

Notice 2020-29 also permits an employer to amend its Section 125 Plan to allow employees to make mid-year flexible spending account changes for any reason on a prospective basis for the remainder of the 2020 calendar year. For example, an employer may amend its Health FSA to allow an employee to revoke an election, make a new election, or decrease or increase an existing election.

Note: Employers may also decide to limit the extent to which the flexible spending account election changes are allowed. For example, to prevent over-spent flexible spending accounts, an employer could choose to limit mid-year election changes to amounts no less than the amounts already reimbursed. For ease of administration, employers may also consider limiting the time period during which these changes are allowed.

Extended Period to Incur Claims for Health FSAs and Dependent Care FSAs

In order to provide another way to help employees who may have trouble incurring medical or dependent care expenses during the COVID-19 pandemic, Notice 2020-29 also provides flexibility for Section 125 plans by extending the permissible period to incur Health FSA and/or Dependent Care FSA expenses. Specifically, an employer may now amend its Section 125 plan to permit employees to apply unused amounts remaining in Health FSAs or Dependent Care FSAs as of the end of a grace period ending in 2020 or a plan year ending in 2020, to pay or reimburse qualified expenses incurred through December 31, 2020. (Usually, the IRS rules only allow a maximum grace period up to 2.5 months after the end of the plan year.)

Under the normal carryover rule, a Section 125 plan may permit the carryover of unused amounts remaining in a Health FSA as of the end of a plan year to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to the carryover limit (prior to Notice 2020-33, discussed below, this amount was limited to \$500). Under the IRS rules, for a Health FSA, a Section 125 plan may adopt *either* a carryover or a grace period (or neither).

How would this work?

For example, an employer that sponsors a Section 125 plan with a Health FSA that currently includes a grace period ending on March 15, 2020 (for the 2019 calendar plan year, the time to incur claims would normally end 2.5 months after the end of the plan year) may optionally extend this grace period to December 31, 2020. This would allow employees to apply unused amounts remaining in an employee's Health FSA as of March 15, 2020 to reimburse the employee for medical care expenses incurred through December 31, 2020.

Note: If an employer chooses to extend its 2019 plan year general purpose Health FSA grace period through December 31, 2020, this will impact an employee's Health Savings Account (HSA) eligibility. If an employee has unused amounts remaining at the end of the plan year (e.g., as of December 31, 2019) and the employer extends the 2019 general purpose Health FSA grace period through December 31, 2020 — the employee will be HSA ineligible for all of 2020.

Health FSA Examples

Below are two examples explaining how the extended claim period can apply to Health FSAs with a grace period or with a carryover provision:

Example 1 — with a grace period: Employer A sponsors a Section 125 plan with a Health FSA that has a calendar year plan year and provides for a grace period ending on March 15th immediately following the end of each plan year. Employer A may now amend its Section 125

plan to permit employees to apply unused amounts remaining in their Health FSAs as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020.

Example 2 – with a carryover provision: Employer B sponsors a July 1st through June 30th plan year Health FSA with a \$500 carryover limit, and employees have more than \$500 remaining in their Health FSA at the end of the plan year ending June 30, 2020 (i.e., the “2019 plan year”). Employer B may now amend the Section 125 plan to permit employees to incur Health FSA claims through the end of calendar year 2020, allowing for claims incurred through December 31, 2020, to be paid with carryover amounts from the 2019 plan year.

Increased Carryover Limit for Health FSAs

As discussed briefly above, the IRS generally permits a Health FSA to include a carryover provision that unused amounts remaining in an account as of the end of a plan year may be used to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to the carryover limit (which was previously \$500).

Notice 2020-33 now permits Health FSAs under a Section 125 plan to be amended to increase the prior maximum \$500 carryover limit for plan years starting in 2020 to \$550, which is 20 percent of the current inflation-adjusted \$2,750 limit on Health FSA contributions.

Note: This is a permanent change.

COVID-19 Relief for HDHPs Is Further Clarified

In one of the earliest pieces of COVID-19 guidance, the IRS issued Notice 2020-15 on March 11, 2020, stating that a High Deductible Health Plan (HDHP) will not lose its qualifying HDHP status because COVID-19 treatment and testing are covered prior to the participant satisfying the applicable plan deductible (i.e., on a “first-dollar basis”).

Notice 2020-29 clarifies that diagnostic testing for influenza A&B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) are included as part of the “testing and treatment for COVID-19” that may be provided on a first-dollar basis without jeopardizing a plan’s HDHP status.

Notice 2020-29 further clarifies that telehealth and other remote care services may be provided on a first-dollar basis through an HDHP without jeopardizing an individual’s HSA eligibility retroactively to January 1, 2020.

Employer Takeaways

These new permissive rules provide both temporary and permanent relief to employees and employers. Employers should consider whether, and to what extent, to offer these temporary mid-year election change opportunities, whether to offer extended Health FSA or Dependent Care FSA periods to incur claims, and whether to offer the increased carryover amount for Health FSAs.

If an employer decides to implement any of the changes provided for under the Notices, the Section 125 plan must be amended by December 31, 2021. Even though the IRS guidance is generous with respect to the timing of the plan amendments, employers should inform employees of these changes through an ERISA Summary of Material Modification as soon as possible.

Before making any final decisions, employers should also coordinate with their third-party administrators and insurance carriers to determine whether they can administer such plan changes.

¹ An employer may rely on an employee's written attestation, unless the employer has actual knowledge that the employee is not, or will not be, enrolled in other comprehensive health coverage that is not sponsored by the employer.

[EMAIL GISUE MEHDI](#)