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IRS Issues Relief for Cafeteria Plans in Response to COVID-19

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On May 12, 2020, in response to the COVID-19 pandemic, the Internal Revenue Service ("IRS") issued two notices, Notice 2020-29 and Notice 2020-33, providing welcome relief and guidance to employers sponsoring Section 125 cafeteria plans ("Section 125 plans"), health flexible spending accounts ("health FSAs"), dependent care assistance programs ("DCAPs"), and qualified high deductible health plans ("HDHPs").

Briefly, the guidance:

- Permits mid-year election changes during the 2020 calendar year for health coverage, health FSAs, and DCAPs as a result of the COVID-19 pandemic.
- Extends claims periods for employees to apply unused amounts remaining in a health FSA or DCAP for expenses incurred for those same qualified benefits through December 31, 2020.

- Clarifies that the relief for HDHPs to cover expenses related to testing for and treatment of COVID-19 and the temporary exemption for telehealth services apply retroactively to January 1, 2020.
- Increases the limit of unused health FSA carryover amounts to \$550 from \$500.
- Clarifies reimbursement rules associated with Individual Coverage Health Reimbursement Arrangements ("ICHRA").

IRS Notice 2020-29: Cafeteria Plan and HDHPs

Elections under a Cafeteria Plan

Generally, pre-tax elections made under a Section 125 plan are irrevocable except as permitted under the circumstances described in the election change regulations (such as if the employee experiences a change in status

or there are significant changes in the cost of coverage) and incorporated in an employer's written cafeteria plan document.

Notice 2020-29 provides temporary flexibility with respect to the irrevocable election rules due to the challenges facing employers and participants due to the COVID-19 pandemic.

Under this relief, an employer may amend its Section 125 plan to allow employees who are eligible to make salary reduction contributions under the plan to make the following prospective election changes during the 2020 calendar year:

1. Make a new election for employer-sponsored health coverage, where the employee had initially declined to elect such coverage.
2. Revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the employer (including changing enrollment from self-only coverage to family coverage).
3. Revoke an existing election for employer-sponsored health coverage, provided that the employee must attest in writing that he or she is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer.
4. With respect to a health FSA election, revoke an election, make a new election, or decrease or increase an existing election.
5. With respect to a DCAP election, make a new election, or decrease or increase an existing election.

An employer is not required to adopt any of the election change options offered by Notice 2020-29 and may choose to adopt only some of the options. To address Section 125 plans that may have permitted mid-year election changes prior to issuance of this guidance, the relief may apply retroactively to January 1, 2020 consistent with this guidance.

Additionally, an employer is not required to permit participants to make unlimited election changes. It may determine the extent to which election changes are permitted and applied, as long as such changes apply prospectively and comply with the Section 125 nondiscrimination rules.

To prevent the potential for adverse selection as a result of adopting these new permitted election changes, an employer may consider limiting elections to circumstances where the employee's coverage will be increased or improved as a result of the election.

The relief relating to employer-sponsored health coverage applies to employers who sponsor both fully insured health coverage as well as those who sponsor self-funded health coverage. It is important to note that nothing in the IRS guidance requires carriers or self-funded health plans (including stop loss insurance) to permit mid-year enrollment and/or coverage changes for COVID-19 related reasons. Prior to implementing these new mid-year election changes under the cafeteria plan rules (specifically, Option #1, #2 and/or #3 above), it is important to understand whether the carrier (or plan terms) will allow for such changes mid-year.

The relief relating to health FSAs applies to all health FSAs, including limited purpose health FSAs. Additionally, with respect to health FSAs and DCAPs, an employer may limit mid-year elections to amounts no less than those amounts that have already been reimbursed.

Written Attestation Required When Coverage Is Dropped.

If an employer permits an employee to revoke an existing election for employer-sponsored health coverage under Option #3 above, the employer must receive written attestation from the employee that the employee is either already enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer. The employer may rely on such written attestation provided by the employee, unless the employer has actual knowledge that the employee is not, or will not be, enrolled in other comprehensive health coverage not sponsored by the employer.

Notice 2020-29 offers the following as an example of an acceptable written attestation:

Name: _____ (and other identifying information requested by the employer for administrative purposes).

I attest that I am enrolled in, or immediately will enroll in, one of the following types of coverage: (1) employer-sponsored health coverage through the employer of my spouse or parent; (2) individual health insurance coverage enrolled in through the Health Insurance Marketplace (also known as the Health Insurance Exchange); (3) Medicaid; (4) Medicare; (5) TRICARE; (6) Civilian Health and Medical Program of the Department of Veterans Affairs (CHAMPVA); or (7) other coverage that provides comprehensive health benefits (for example, health insurance purchased directly from an insurance company or health insurance provided through a student health plan).

Signature: _____

Extended Claims Periods for Health FSAs and DCAPs

Notice 2020-29 also provides that an employer may amend its Section 125 plan to provide for an extended period during which a participant may apply unused amounts remaining in a health FSA or DCAP to pay or reimburse medical care expenses or dependent care expenses incurred through December 31, 2020 when the plan year or grace period ends in 2020.

For example, an employer who sponsors a Section 125 plan with a health FSA that has a plan year that runs from January 1 to December 31, with a grace period ending on March 15 immediately following the end of each plan year, may amend the Section 125 plan to permit participants to apply unused amounts in the health FSA as of March 15, 2020, to reimburse the participant for qualified expenses incurred through December 31, 2020. It should be noted that Section 125 plans with a plan year ending on or after October 31, 2020 will not need this relief, as they will continue to be able to provide a grace period of up to two months and 15 days, which would permit the reimbursement of qualified expenses incurred after December 31, 2020.

Generally, a health FSA may either provide for a grace period or a carryover amount but may not have both. This relief is available both to Section 125 plans that have a grace period and those that provide for a carryover.

Notice 2020-29 provides the following examples to illustrate how a Section 125 plan with a July 1 plan year and a \$500 carryover would implement the extended period for incurring claims allowed:

Example 1

An employer provides a health FSA under a Section 125 plan that allows a \$500 carryover for the plan year ending June 30, 2020. In accordance with the relief provided for in Notice 2020-29 and Notice 2020-33, the employer may amend the Section 125 plan to adopt a \$550 carryover (see below for a discussion regarding Notice 2020-33) beginning with the 2020 plan year, and may also amend the plan to adopt a temporary extension that allows for claims incurred on or before December 31, 2020, to be paid with respect to health FSA balances remaining from plan year ending June 30, 2020.

Employee A has a remaining balance of \$2,000 in his health FSA for the plan year ending June 30, 2020. Employee A has elected to contribute \$2,000 to his health FSA for the plan year beginning July 1, 2020. He incurs \$1,900 in medical care expenses between July 1, 2020 and December 31, 2020. The health FSA may reimburse Employee A \$1,900 from the \$2,000 remaining in his health FSA as of June 30, 2020, leaving \$100 remaining in the health FSA from the plan year ending June 30, 2020. Because the plan provides for a carryover, Employee A may use the remaining \$100 in his health FSA through June 30, 2021, to reimburse claims incurred during the plan year ending June 30, 2021. Employee A may be reimbursed up to \$2,100 (representing the \$2,000 contributed to the health FSA for the July 1, 2020 through June 1, 2021 plan year, plus the \$100 carryover from the plan year ending June 30, 2020) for qualified expenses incurred between January 1, 2021 and June 30, 2021. Employee A may also carry over up to \$550 of any remaining balance of the \$2,100 to the plan year beginning July 1, 2021. A grace period will not be available to Employee A for the plan year ending June 30, 2021.

Example 2

Assume the same facts as Example 1, but here Employee B has \$1,250 remaining in her health FSA as of June 30, 2020. Employee B has elected to contribute \$1,200 to her health FSA for the plan year beginning July 1, 2020. Employee B incurs \$600 in qualified medical expenses between July 1, 2020 and December 31, 2020. Employee B's health FSA may reimburse her \$600 from the \$1,250 balance in her health FSA as of June 30, 2020, leaving the remaining \$650. Under the terms of the health FSA, Employee B may use \$500 of her remaining \$650 balance to reimburse for claims she incurs during the 2020 plan year. The remaining \$150 will be forfeited. Employee B may be reimbursed for up to \$1,700 (representing the \$500 that was carried over from the plan year ending June 30, 2020, plus the \$1,200 she had elected to contribute for the plan year beginning July 1, 2020) for qualified expenses incurred between January 1, 2021 and June 30, 2021. Employee B may carry over up to \$550 of any remaining unused portion of the \$1,700 to the plan year beginning July 1, 2021, after claims have been processed for the plan year ending June 30, 2021. As with the previous example, a grace period will not be available to Employee B for the plan year ending June 30, 2021.

Coordination with HDHPs

The extension of the period for incurring claims that may be reimbursed by the health FSA is an extension of coverage by a health plan that is not an HDHP for purposes of determining whether an eligible individual qualifies to make contributions to an HSA (except in the case of an HSA-compatible health FSA, such as a limited purpose health FSA). Therefore, an individual who had unused amounts remaining at the end of a plan year or grace period ending in 2020 and who is allowed an extended period to incur expenses (until December 31, 2020) under a health FSA will not be eligible to contribute

to an HSA during the extended period (except in the case of an HSA-compatible health FSA, including a health FSA that is amended to be HSA-compatible). Employers considering this relief should understand the effect that extending the benefit may have on HSA eligibility. It is possible that extending a traditional health FSA it could have the effect of disqualifying individuals from HSA eligibility. It would appear that, to preserve HSA eligibility, the FSA many need to be amended to be HSA-compatible (for example, converting the health FSA for all participants to a limited purpose health FSA for the duration of the extension). Further guidance in this area would be helpful.

Plan Amendments

An employer who amends its Section 125 plan to provide mid-year election changes or an extended period to apply unused amounts remaining in the health FSA or DCAP must adopt a plan amendment reflecting such changes to the plan.

Amendments must be adopted on or before December 31, 2021 and may be effective retroactively to January 1, 2020. The employer must also inform all employees who are eligible to participate in the Section 125 plan of relevant changes to the plan.

HDHPs

The IRS guidance makes the following clarifications to previous guidance:

- Expenses related to treatment for and testing of COVID-19 applies with respect to reimbursements of expenses incurred on or after January 1, 2020.
- For this purpose, treatment and testing of COVID-19, required to be provided without cost-sharing, includes the panel of diagnostic

testing for influenza A and B, norovirus and other coronaviruses, and respiratory syncytial virus (“RSV”).

Additionally, the guidance clarifies that telehealth or other remote services provided on or after January 1, 2020 with respect to plan years beginning on or before December 31, 2021 will not be disqualifying for purposes of HSA eligibility. Therefore, if an otherwise HSA eligible individual received telehealth services before satisfaction of the deductible in February 2020 (before the safe harbor became effective), the individual would not be disqualified from making HSA contributions.

IRS Notice 2020-33: Health FSA Carryover and ICHRAs

Maximum Carryover Increased to \$550 for 2020 Plan Years

The IRS simultaneously issued Notice 2020-33 to increase the carryover limit for unused amounts remaining in a health FSA as of the end of a plan year from a maximum of \$500 to \$550. This increase reflects a change from the static \$500 carryover amount to 20% of the currently indexed health FSA contribution limit. For 2020, 20% of the current \$2,750 limit on health FSA contributions is \$550. Thus, the maximum unused amount from a health FSA plan year that begins in 2020 that can be carried over to the following plan year (2021) is \$550.

For plan years beginning in 2020, with respect to either (1) adding a carryover for a health FSA plan year or (2) increasing the maximum carryover to \$550, the rules state an amendment must be adopted on or before December 31, 2021.

With respect to plan years beginning in 2021 (or later), an amendment to increase the carryover amount may be

adopted at any time on or before the last day of the plan year. Employers should notify plan participants of the change.

Individual Insurance Policies and ICHRAs

Additionally, Notice 2020-33 clarifies that a health plan may reimburse individual insurance policy premium expenses that had been incurred prior to the beginning of a plan year for coverage provided during the plan year. This relief is intended to assist employers who are implementing ICHRAs, which are employer-sponsored health plans designed to reimburse employees for substantiated premiums for individual health insurance coverage and other medical care expenses). Notice 2020-33 provides that an ICHRA with a calendar year plan year may immediately reimburse a substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium for the coverage prior to the first day of the plan year.

- If currently offering the health FSA carryover, determine whether to increase the dollar limit to \$550 for plan years that begin in 2020.
- Appropriately amend the Section 125 plan and notify plan participants of the changes in a timely manner.

Employer Action

Employers should coordinate with their third-party administrators (and carriers as applicable) and:

- Review the new available mid-year election change designs for 2020 plan years and determine whether to implement them. Carrier approval should be obtained prior to implementing mid-year election changes that affect medical, dental and vision coverage. This includes stop loss carrier approval.
- Determine whether to offer the extended claims period for health FSA and DCAP expenses for 2020. Employers should be mindful of potential issues that arise with respect to HSA eligibility if traditional health FSA coverage is extended.