COMPLIANCE ALERT

EMPLOYEE BENEFITS | MAY 12, 2020

IRS Relaxes Election Change, Other Rules for Cafeteria Plans and FSAs

As the country continues to feel the impact of the COVID-19 National Emergency declared by President Trump on March 13, 2020, the IRS has provided some much needed guidance and relief for employees. On May 12, 2020, the IRS issued Notices **2020-29** and **2020-33**, which, among other things, extend the claims period for health flexible spending arrangements (health FSAs) and dependent care assistance programs (DCAPs) and allow employees to make mid-year changes. These Notices are summarized in more detail below.

Notice 2020-29

MID-YEAR ELECTION CHANGES

Under Section 125 of the Internal Revenue Code, elections for qualified benefits are generally irrevocable for the plan year unless one of the permitted election change events applies. Permitted election changes allow an employee to revoke their election mid-year and make a new election on account of certain events, such as a change in status, among others.

As a result of COVID-19, some carriers offered special enrollment opportunities for employees who were otherwise eligible for the employer's coverage, but declined coverage at open enrollment. While this may have been appreciated by employees, many employers questioned whether there was a permitted election change event under Section 125 that matched this enrollment opportunity or whether it was safer to require employees who took advantage of the opportunity to participate in the plan with after-tax contributions for the remainder of the plan year.

Additionally, many employees who previously elected to contribute to their health FSA have experienced a decrease in medical expenses as they comply with their state or local government stay-at-home orders. Therefore, they have not been able to use their health FSA contributions. Usage of DCAPs has also been disrupted due to day care closures.

Notice 2020-29 addresses these issues for calendar year 2020 by allowing cafeteria plans to be amended to permit employees to make mid-year election changes for the following purposes:

- For employer-sponsored health coverage:
  - Make a new, prospective election if the employee had previously declined coverage;
  - Revoke an existing election and make a new, prospective election to enroll in different health coverage sponsored by the employer; or
  - Prospectively revoke coverage if the employee attests in writing that they are enrolled in, or immediately enroll in, other health coverage not sponsored by the employer. The Notice provides a sample attestation employers can use and may rely on the written attestation unless the employer has actual knowledge

the employee is not, or will not be, enrolled in other comprehensive health coverage.

- For FSA coverage:
  - Prospectively revoke an election, make a new election, or decrease or increase an election to a health FSA (including a limited purpose health FSA) or DCAP.

Notice 2020-29 provides that employers may amend their plans to allow each eligible employee to make prospective election changes or an initial election regardless of whether the election change satisfies one of the permitted election changes under applicable Treasury regulations. The Notice is very clear that this is not a free-for-all. The employer has the discretion to impose parameters for these election changes, including the extent to which the election changes are permitted and applied, and they can limit the period during which election changes may be made.

The relief may be applied retroactively to January 1, 2020; however, as set forth above, all election changes must be prospective. The retroactive application of the relief is to cover any employer who may have allowed an election change that may not have been consistent with Section 125 (but would be consistent with one of the permitted election changes discussed above).

Finally, employers must ensure the election changes do not result in failure to comply with the nondiscrimination rules. The Notice provides strategies an employer may use to ensure there is no adverse selection of health coverage, such as limiting elections to circumstances in which an employee's coverage will be increased or improved as a result of the election change (ex. switching from self-only to family coverage).

FSA CARRYOVER RULES

Pursuant to Section 125, cafeteria plans may adopt a carryover, which allows participants to carryover unused amounts remaining at the end of the plan year. The carryover allows the plan to reimburse participants for medical care expenses incurred during the following plan year (up to $550 – see the discussion of Notice 2020-33 below). Alternatively, a plan may adopt a grace period, which gives plan participants up to an additional two and one-half months to apply any unused funds remaining in the health FSA or DCAP at the end of the plan year. The plan may adopt either carryover or the grace period (not both), or the plan can choose not to offer either option.

Because the COVID-19 National Emergency will likely result in employees having unused health FSA or DCAP contributions at the end of the plan year, Notice 2020-29 allows an employer to amend its plan to permit employees to apply any unused amounts in a health FSA or DCAP at the end of a plan year ending in 2020 (or grace period ending in 2020, if applicable) to pay or reimburse medical care expenses or dependent care expenses, respectively, incurred for the same qualified benefit through December 31, 2020. Even plans with a carryover may adopt this grace period (despite the prohibition on having both a carryover and a grace period).

This extension applies to all health FSAs (including limited purposes FSAs) and, if adopted, may potentially impact an employee's eligibility to contribute to an HSA (unless the health FSA is a limited purpose health FSA) during the extended period.

This relief can be applied on or after January 1, 2020 and on or before December 31, 2020 provided any elections made pursuant to the relief are made only on a prospective basis.

HIGH DEDUCTIBLE HEALTH PLANS

COVID-19 testing and treatment

Under current law, with limited exceptions, a high deductible health plan (HDHP) will fail to be HSA-qualified if it allows certain medical care services or items to be purchased prior to meeting the applicable minimum deductible.

Notice 2020-15, issued by the IRS in March, provided that a HDHP would not fail to meet its qualified status simply by allowing participants to receive testing and treatment of COVID-19 without having to meet the minimum deductible.

Notice 2020-29 clarifies that this applies with respect to reimbursements incurred on or after January 1, 2020 and that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) and any items and services required to be covered with zero cost sharing pursuant to the FFCRA, as amended by the CARES Act, are covered pursuant to Notice 2020-15.

Telemedicine

Similarly, for purposes of the temporary safe harbor (through plan years beginning on or before December 31, 2021) for a qualified HDHP to provide coverage for telehealth and other remote care services at no cost to employees without disrupting HSA eligibility, Notice 2020-29 provide that this will apply for purposes of services provided on or after January 1, 2020 with respect to plan years beginning on or before December 31, 2021.

Employers have until December 31, 2021 to adopt any of the plan amendments described in Notices 2020-29 and 2020-33 and the plan amendment may apply retroactively to January 1, 2020; however, employers must inform their employees eligible to participate in the plan of these changes.

Notice 2020-33

HEALTH FSA CARRYOVER LIMIT

Notice 2020-33 modifies prior guidance by indexing the health FSA carryover limit ($500) for inflation consistent with the indexed limit for the health FSA contribution limit for 2020. Therefore, the health FSA carryover limit increases by 20%, from $500 to $550 effective January 1, 2020.

If a cafeteria plan chooses to increase the carryover limit to $550, it must notify all individuals eligible to participate in the plan of this change and will have until December 31, 2021 to adopt a plan amendment.

INDIVIDUAL COVERAGE HRAS (ICHRAS)

Individual coverage health reimbursement arrangements (ICHRAs) are HRAs an employer may adopt under certain circumstances to allow employees to reimburse premiums for individual health insurance (or Medicare premiums) and other medical care expenses if certain circumstances are satisfied. An ICHRA is an employer-sponsored health plan and reimbursements for medical expenses incurred by a participating employee during the plan year are excluded from the employee's gross income.

The limitation on the ICHRA to reimburse only those medical care expenses incurred within the plan year creates an administrative issue when participants must pay their premiums before the first day of the plan year. To overcome this administrative issue, Notice 2020-33 allows an ICHRA to treat an expense for a premium for health insurance coverage as incurred on:

- the first day of each month of coverage on a pro rata basis
- the first day of the period of coverage, or
- the date the premium is paid.

Employers who would like to avail themselves of the relief provided in the Notices should work with their ERISA attorney, insurance broker or cafeteria plan vendor to ensure the plan is amended to reflect any conditions or limitations the employer may apply.

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