

COMPLIANCE ALERT

IRS RELAXES SECTION 125 ELECTION CHANGE RULES, EXPANDS GRACE PERIODS AND CARRYOVERS

May 12, 2020

QUICK FACTS

- For calendar year 2020, a cafeteria plan may permit employees who are eligible to make salary reduction contributions for employer-sponsored health coverage to prospectively make or revoke elections under certain newly-outlined circumstances.
- Employees also may prospectively revoke an election, make a new election, or decrease or increase an existing election applicable to a health flexible spending account (HFSA) or dependent care assistance program (DCAP).
- In addition, a cafeteria plan may allow employees to apply unused Health FSA or DCAP amounts remaining at the end of a grace period or plan year ending in 2020, to pay for eligible expenses incurred through December 31, 2020.
- The Notice clarifies the time period during which high-deductible health plans (HDHP) can apply prior IRS relief that permitted first-dollar coverage for COVID-19 testing and expanded telehealth without violating HDHP rules or rendering participants ineligible for a health savings account (HSA).

The Internal Revenue Service (IRS) today issued Notice 2020-29 (Notice) to provide cafeteria plan sponsors much-anticipated guidance on permissible midyear election changes for Section 125 plans as well as HFSA and DCAPs. The Notice also addresses issues regarding grace periods for claims reimbursement and provides details on previous guidance affecting high-deductible health plans (HDHP).

Background

Internal Revenue Code (IRC) Section 125 allows employers to adopt a written plan to let employees elect to pay for certain benefits, including group health plan coverage, on a pre-tax basis through salary reductions. Section 125 also permits employees to contribute pre-tax reductions to an HFSA or DCAP and certain other benefits.

Employees generally cannot change cafeteria plan elections during the year unless they experience a change in status that allows for an election change under specific limited circumstances allowed in IRS regulations. For example, if a written cafeteria plan allows, an employee generally can make a midyear change due to marriage

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or birth of a child, or if there are significant changes in the cost of coverage. As employers have dealt with the COVID-19 outbreak, many questions have arisen as to how the cafeteria plan election rules apply to the many unforeseen circumstances created by the current pandemic.

Midyear Election Changes

The COVID-19 public health emergency has created unanticipated changes in the need for or availability of medical care. Thus, some employers have been willing to offer employees who initially declined to elect group health coverage another chance to elect health coverage, or to allow employees enrolled in group health coverage to enroll in different health coverage offered by the same employer or drop existing employer-sponsored health coverage to enroll in other health coverage not offered by their employer (e.g., coverage offered by their spouse's employer).

Moreover, some employees may have had more or fewer medical expenses due to unforeseeable changes in the need for or availability of medical care, and so wish to increase or decrease amounts in their health FSAs. Some employees similarly may have increased or decreased dependent care assistance needs due to unanticipated school and child care provider closures or changes to work location or schedule. Unfortunately the limited exceptions in existing relevant election change regulations may not apply to requested health coverage, HFSA, and DCAP election changes for these reasons.

The Notice allows an employer to amend its cafeteria plan (including limiting the period during which election changes may be made) to allow each employee who is eligible to make salary reduction contributions under the plan to make prospective election changes (including an initial election) during calendar year 2020 regarding employer-sponsored health coverage, a health FSA, or a DCAP, regardless of whether the basis for the election change satisfies the standard change in status criteria in IRS regulations.

The IRS specifically will allow employers to amend a cafeteria plan to allow employees to prospectively:

- make a new election for employer-sponsored health coverage, if the employee initially declined to elect employer-sponsored health coverage;
- revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer (including changing enrollment from self-only coverage to family coverage);

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- 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 health coverage not sponsored by the employer;
- revoke an election, make a new election, or decrease or increase an existing election regarding an HFSA; and
- revoke an election, make a new election, or decrease or increase an existing election regarding a DCAP.

An employer can accept an employee's revocation of existing employer health coverage only if the employee attests in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer. The IRS provides the following language as a suitable revocation:

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: _____

Employers do not need to allow unlimited changes under the Notice. The IRS states that employers may limit changes to only those that expand or increase coverage, for example.

The guidance applies to self-funded and fully insured group health plans as well as to general purpose and limited purpose HFSA's.

Finally, the Notice applies to any prospective cafeteria plan election changes related to group health coverage, HFSA's and DCAP's made on and after January 1, 2020, consistent with the requirements for the relief provided in the Notice.

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Grace Periods and Carryovers

An employer may amend its cafeteria plans to permit employees to apply unused amounts remaining in an HFSAs or a DCAP as of the end of a grace period ending in 2020 or a plan year ending in 2020 to pay or reimburse expenses incurred for the same qualified benefit through December 31, 2020. So, an employer can amend an HFSAs that has a calendar year plan year and a grace period ending on March 15 immediately following the end of each plan year to let employees apply unused amounts remaining in their HFSAs as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020. An HFSAs with a carryover feature rather than a grace period also can extend the claims deadline as explained below.

Example 1. *Employer provides a health FSA under a § 125 cafeteria plan that allows a \$500 carryover for the 2019 plan year (July 1, 2019 to June 30, 2020). Pursuant to this notice and Notice 2020-33, Employer amends the plan to adopt a \$550 (indexed) carryover beginning with the 2020 plan year, and also amends the plan to adopt the temporary extended period for incurring claims with respect to the 2019 plan year, allowing for claims incurred prior to January 1, 2021, to be paid with respect to amounts from the 2019 plan year.*

Employee A has a remaining balance in his health FSA for the 2019 plan year of \$2,000 on June 30, 2020, because a scheduled non-emergency procedure was postponed. For the 2020 plan year beginning July 1, 2020, Employee A elects to contribute \$2,000 to his health FSA. Employee A is able to reschedule the procedure before December 31, 2020 and, between July 1, 2020 and December 31, 2020, incurs \$1,900 in medical care expenses.

The health FSA may reimburse Employee A \$1,900 from the \$2,000 remaining in his health FSA at the end of the 2019 plan year, leaving \$100 unused from the 2019 plan year. Under the plan terms that provide for a carryover, Employee A is allowed to use the remaining \$100 in his health FSA until June 30, 2021, to reimburse claims incurred during the 2020 plan year. Employee A may be reimbursed for up to \$2,100 (\$2,000 contributed to the health FSA for the 2020 plan year plus \$100 carryover from the 2019 plan year) for medical care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee A may carry over to the 2021 plan year beginning July 1, 2021 up to \$550 of any remaining portion of that \$2,100 after claims are processed for the 2020 plan year that began July 1, 2020. A grace period is not available for the plan year ending June 30, 2021.

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***Example 2.** Same facts as Example 1, except that Employee B has a remaining balance in his health FSA for the 2019 plan year of \$1,250 on June 30, 2020. For the 2020 plan year beginning July 1, 2020, Employee B elects to contribute \$1,200 to his health FSA. Between July 1, 2020 and December 31, 2020, Employee B incurs \$600 in medical care expenses. The health FSA may reimburse Employee B \$600 from the \$1,250 remaining in his health FSA at the end of the 2019 plan year, leaving \$650 unused from the 2019 plan year. Under the plan terms, Employee B is allowed to use \$500 of the \$650 unused amount from the 2019 plan year to reimburse claims incurred during the 2020 plan year, and the remaining \$150 will be forfeited. Employee B may be reimbursed for up to \$1,700 (\$1,200 contributed to the health FSA for the 2020 plan year plus \$500 carryover from the 2019 plan year) for medical care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee B may carry over to the 2021 plan year beginning July 1, 2021 up to \$550 of any remaining unused portion of that \$1,700 after claims are processed for the 2020 plan year that began July 1, 2020. A grace period is not available for the plan year ending June 30, 2021.*

The IRS stresses that an individual with 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 under an HFSA pursuant to a plan amended as the Notice allows is **NOT** eligible to contribute to an HSA during the extended period (except for an HSA-compatible HFSA, including an HFSA that is amended to be HSA-compatible).

The carryover and grace period relief applies to any prospective changes made on or after January 1, 2020, and on or before December 31, 2020.

Cafeteria Plan Amendments

Employers who wish to allow their employees to take advantage of the relief allowed by the Notice must amend their written cafeteria plans. The Notice states that an employer will have until December 31, 2021, to adopt an amendment retroactively to January 1, 2020, as long as the employer operates the plan according to the guidance in the Notice. Further, any amendment pursuant to the Notice will apply only to changes made during calendar year 2020, or to an extended period to apply unused HFSA amounts or DCAP amounts to pay for or reimburse medical care or dependent care expenses incurred through December 31, 2020.

HDHP/HSA Guidance

Prior IRS guidance following the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief and Economic Security Act (CARES Act) provided that an HDHP would not fail to be an HDHP simply

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because it provided for mandatory coverage of COVID-19 testing and treatment, or allowed for telehealth services, before meeting the HDHP deductible. The Notice clarifies that the prior guidance applies to reimbursements of COVID-19 expenses incurred on or after January 1, 2020. The Notice further clarifies that 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 FFCRA, as amended by the CARES Act, are part of testing and treatment for COVID-19 for these purposes.

Additionally, the Notice clarifies that telehealth and other remote care services received on or after January 1, 2020, and with respect to plan years beginning on or before December 31, 2021, will not cause an HDHP to fail to be an HDHP, nor would it render someone ineligible to contribute to an HSA. For example an otherwise eligible individual with coverage under an HDHP, who also received coverage beginning February 15, 2020, for telehealth and other remote care services under an arrangement that is not an HDHP before satisfying the HDHP deductible, will not be disqualified from contributing to an HSA during 2020.

Conclusion

These continue to be trying times, but the IRS remains committed to helping employers and employees who are grappling with difficult plan coverage and administrative matters during the COVID-19 crisis. This Notice should allow employers – especially those that may have allowed cafeteria plan election changes not technically permitted under existing regulations – to breathe easier when faced with employee requests for midyear cafeteria plan, HFSA and DCAP election changes.

Employers who have allowed these changes, or wish to, must remember that the Notice requires them to adopt written plan amendments by no later than December 31, 2021. Many FSA vendors prepare cafeteria plan documents for their clients, so they may provide the amendments required to adopt the new permitted plan rules. Employers also should properly notify employees of the changes, if adopted.

EPIC Employee Benefits Compliance Services

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