
Employee Benefits Update

May 20, 2020

The Impact of the COVID-19 Pandemic on Your Employee Benefit Plans: Part 6

Changes to Cafeteria Plan Mid-Year Election Rules, Increase of Health FSA Carryover Limit, Extension of Health & Dependent Care FSA Claims Periods, and Clarifications about Prior Changes

Executive Summary

The Internal Revenue Service (the “IRS”) and the Treasury Department recently issued [Notice 2020-29](#) and [Notice 2020-33](#) (the “Notices”). This client alert addresses how these Notices provide guidance to employers who wish to provide additional flexibility to their employees during the COVID-19 pandemic with respect to their benefit elections under cafeteria plans, health flexible spending arrangements (health FSAs), and dependent care flexible spending arrangements (dependent care FSAs). The Notices also modestly increase the carryover limit for health FSAs, extend the health FSA and dependent care FSA claims period, and clarify the ability of individual coverage health reimbursement arrangements (HRAs) to reimburse premiums incurred prior to the beginning of a plan year.



Mid-Year Election Changes Permitted Under Cafeteria Plans for 2020 Only

A cafeteria plan—often referred to as a “Section 125 plan” or a “flexible benefits plan”—is a plan maintained by an employer that allows employees to choose between receiving taxable income or receiving “qualified benefits”, such as health insurance coverage, health FSAs, and dependent care FSAs, which are not included in gross income. Under the cafeteria plan rules, participant elections generally must be made prior to the first day of the plan year and must be irrevocable for that plan year, except in certain limited circumstances, such as if the employee experiences a change in status or there are significant changes in the cost of coverage.

IRS Notice 2020-29 temporarily loosens the cafeteria plan rules to permit employees to prospectively change their elections, mid-year, for health coverage, health FSAs (including limited purpose health FSAs compatible with high deductible health plans and health savings accounts), and dependent care FSAs, for the 2020 calendar year. Specifically, an employer, in its discretion, may (but is not required to) amend its cafeteria plan to allow eligible employees to:

- make a new election to enroll in health coverage, if the employee initially declined to elect such coverage;
- revoke an existing health coverage election and make a new election to enroll in different health coverage (including changing enrollment from self-only coverage to family coverage);
- revoke an existing election for health coverage, provided the employee attests in writing that the employee is enrolled, or will immediately enroll, in other comprehensive health coverage not sponsored by the employer. ([Notice 2020-29](#) provides template language for the written employee statement.) The employer can rely on this statement, unless the employer has actual knowledge that the employee is not or will not be enrolled in other comprehensive health care coverage;
- revoke an election, make a new election, or decrease/increase an existing health FSA election; and
- revoke an election, make a new election, or decrease/increase an existing election regarding a dependent care FSA.

Employers taking advantage of the Notice 2020-29 relief may determine the extent to which election changes are permitted and applied, provided that any permitted election changes are provided on a *prospective basis only* and the changes to the election requirements do not result in failure to comply with the nondiscrimination rules applicable to cafeteria plans. For example, an employer may choose to:

- √ limit the period during the 2020 calendar year in which the election changes can be made;
- √ limit the number of election changes;
- √ for health FSAs and dependent care FSAs, limit mid-year election changes to amounts no less than amounts already reimbursed, in order to limit the employer's financial exposure; or
- √ limit election changes to those that increase or improve an employee's coverage.

Employers must inform all employees eligible to participate in their cafeteria plans about changes made to the election requirements for the 2020 calendar year. A formal amendment to the cafeteria plan must be adopted on or before December 31, 2021.

Increase in Carryover Limit for Health FSAs

Under current regulations, any unused amounts remaining in a health FSA at the end of a plan year are forfeited under the “use it or lose it” rule, unless the cafeteria plan allows a carryover of unused amounts up to \$500, or a grace period during which an employee can apply unused amounts to pay qualifying expenses incurred during the grace period.

Recognizing that the carryover limit has not kept pace with increases in the maximum amount an employee can contribute to a health FSA—which is \$2,750 for 2020—IRS Notice 2020-33 increases the carryover limit to 20 percent of the maximum salary reduction contribution for the plan year, rounded to the next lowest multiple of \$10. This means that the maximum carryover amount from the 2020 plan year, into the 2021 plan year, will be \$550 (20% of \$2,750).

If an employer decides to allow this increased carryover amount, plan participants should be notified, and the cafeteria plan must be formally amended. If the carryover limit is changed for the 2020 plan year, the amendment must be adopted by December 31, 2021. The amendment can include language that references the indexed amount so that the cafeteria plan does not need to be amended each year to reflect increased carryover amounts.

Extended Claims Period through December 31, 2020 for Health and Dependent Care FSAs

IRS Notice 2020-29 permits (but does not require) an employer to provide an extended period to apply unused amounts remaining in health and dependent care FSAs. If an employer adopts this extension, participants will be able to apply unused amounts remaining in a health FSA (whether a general purpose or limited purpose health FSA) or a dependent care FSA at the end of a grace period ending in calendar year 2020 or a plan year ending in 2020 to pay or reimburse expenses incurred through December 31, 2020. The Notice reminds employers that health FSA amounts may be used only for medical care expenses, and dependent care FSA amounts may be used only for dependent care expenses; notably, however, it does not provide for a cash out of unused FSA balances.

This extension of time to apply unused amounts is available both to cafeteria plans that have a grace period and to cafeteria plans that permit carryovers. In addition, an employee with unused amounts in a health FSA remaining at the end of the 2020 plan year or grace period ending in calendar year 2020, and who is allowed an extended period to incur expenses, will not be eligible to contribute to a health spending account (HSA) during the extended period unless the health FSA is a limited purpose health FSA that is HSA-compatible.

If an employer chooses to adopt these optional changes, the employer must inform all employees eligible to participate in the cafeteria plan about the changes, although a formal amendment to the cafeteria plan for the 2020 plan year does not need to be adopted until December 31, 2021.

Clarification Regarding Scope of COVID-19 Diagnostic Testing to Be Covered Without Cost-Sharing

IRS Notice 2020-29 clarifies that COVID-19 diagnostic testing, which is required to be covered without any cost-sharing, includes the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV), as well as any items or services required to be covered with zero cost-sharing under the Families First Coronavirus Response Act and the CARES Act. This coverage applies to expenses incurred on or after January 1, 2020.

Clarification Regarding Telehealth and Remote Care Services

IRS Notice 2020-29 also clarifies that individuals retain eligibility to contribute to an HSA if they also receive coverage for telehealth and other remote care services provided outside a high deductible health plan and before satisfying the minimum deductible. This treatment of telehealth and other remote care services applies with respect to services provided on or after January 1, 2020 for plan years beginning on or before December 31, 2021.

Clarification of Individual Coverage HRA Reimbursement

While the general rule is that individual coverage HRAs cannot reimburse medical care expenses incurred prior to the beginning of the plan year, IRS Notice 2020-33 addresses some of the administrative complexities that can arise in applying that rule when reimbursing individual health insurance premiums. The Notice clarifies that an individual coverage HRA is permitted to treat expenses for health insurance coverage premiums as incurred on (1) the first day of each month of coverage on a pro rata basis; (2) the first day of the period of coverage; or (3) the date the premium is paid. This means, for example, that an individual coverage HRA 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 coverage prior to the first day of the plan year.



To discuss the impact of this recent guidance on your employee benefit plans, please contact any member of our Employee Benefits and Executive Compensation Group below. Please click [here](#) to access Isler Dare’s COVID-19 information webpage.

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