

# COVID-19 COMPLIANCE ALERT

May 14, 2020

## IRS Relaxes Cafeteria Plan Election Change Rules, Extends FSA Grace Periods and Carryovers for COVID-19 Pandemic

On May 12, 2020, the Internal Revenue Service (IRS) released guidance that allows temporary changes to Internal Revenue Code (IRC) Section 125 cafeteria plans. [IRS Notice 2020-29](#) provides some much needed direction for employers, allowing them to provide more mid-year election change opportunities for employees and to extend the claims period for health flexible spending accounts (HFSA) and dependent care assistance programs (DCAPs) to help address the COVID-19 pandemic.

### Key Points

- For calendar year 2020, a cafeteria plan may allow employees who make salary reduction contributions for employer-sponsored health coverage to prospectively make or revoke their cafeteria plan elections in certain circumstances.
- Employees also may prospectively revoke an election, make a new election, or change an existing election for a HFSA or DCAP.
- 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 2020 to pay for eligible expenses incurred through December 31, 2020.
- IRS relief for high deductible health plans (HDHP), which allowed coverage for COVID-19 testing and expanded telehealth without meeting the minimum deductible, may be applied retroactively to January 1, 2020.

## Mid-Year Elections Allowed to Change Health Plan Enrollment and HFSA and DCAP Contributions

IRC Section 125 allows employers to adopt a written plan to allow employees to elect certain benefits, including group health coverage, HFSA, and DCAP, on a pre-tax basis through salary reductions.

Employees generally cannot change their cafeteria plan elections during the plan year unless they experience an event under IRS regulations that allows a mid-year election change. A plan may allow, but is not required, to provide mid-year election changes permitted by Section 125. The IRS guidance expands the circumstances for which a plan may allow mid-year election changes to provide more flexibility during the COVID-19 pandemic.

The IRS goal is to provide relief to plan participants, who may have experienced a change in medical expenses, in medical care needs, or in dependent care due to unanticipated school or child care provider closures. The IRS guidance allows those employers who want to provide more opportunity for mid-year elections to do so, expanding permitted election changes beyond those currently specified by Section 125.

As a result of COVID-19, many carriers offered special enrollment opportunities for employees who had previously declined coverage. Some employers questioned whether this was a permitted cafeteria election change under Section 125 or whether employees who took advantage of the opportunity would have to do so with after-tax dollars for the remainder of the plan year. The IRS notice solves this compliance issue for employers.

**Cafeteria plan sponsors may now allow mid-year election changes for health coverage as follows:**

- Employees who initially declined employer-sponsored health coverage for this plan year may elect to enroll;
- Currently enrolled employees can switch employer-sponsored health plans, revoking a current election and making a new election in different health coverage sponsored by the same employer (including changing enrollment from self-only to family coverage);
- Currently enrolled employees can drop employer-sponsored health coverage if they certify in writing that they are or will immediately enroll in other health coverage.
- Employees may revoke an election, make a new election, or decrease or increase an existing election for an HFSA; and
- Employees may revoke an election, make a new election, or decrease or increase an existing election for a DCAP.

These changes are optional and plans are not required to allow unlimited changes under the IRS guidance. Plans may, per their discretion, determine the extent to which such election changes are permitted and applied, so long as they are prospective. For example, employers may limit changes to only those that expand or increase coverage to discourage adverse selection. Employers should ensure the election changes do not result in a failure to comply with non-discrimination testing rules.

For employers who choose to allow employees to drop employer-sponsored health coverage if they certify in writing they are or will enroll in other health coverage, the IRS provided the following model certification for employers to use:

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: \_\_\_\_\_

## Plans Have Option to Extend Grace Period for FSAs

The IRS also relaxed the “use it or lose it” rule for flexible spending accounts (FSAs). Employers may amend their Section 125 cafeteria plans to permit employees to incur reimbursable claims through the end of calendar year 2020 for any FSA plan year or grace period that ends in 2020. This option applies to both general purpose and limited-purpose HFSA and DCAPs.

This means that expenses incurred this year can be reimbursed from amounts that would have been forfeited as of March 15, 2020 (for a calendar year plan). Sponsors of health FSAs that have a carryover feature may also adopt a grace period for the 2020 plan year only. Employers should work closely with their plan administrator on implementing this new extended period for claims reimbursement.

## IRS Increases Health FSA Carryover Amount

For the 2020 plan year, the maximum carryover amount for HFSA with a carryover feature is increased from \$500 to \$550. The IRS issued a separate notice ([IRS Notice 2020-33](#)) modifying prior guidance and indexing the HFSA carryover limit for inflation. For plan years 2020 and later, the maximum carryover amount is equal to 20% of the maximum HFSA salary reduction contribution for that plan year.

## HDHP/HSA Guidance

Prior IRS guidance provided that an HDHP would not fail to be an HDHP simply because it provided for coverage of COVID-19 testing and treatment, or allowed for telehealth services, before meeting the HDHP minimum deductible. IRS Notice 2020-33 provides that this prior guidance applies to reimbursements of COVID-19 expenses incurred on or after January 1, 2020.

## Next Steps for Employers

Employers should decide whether to offer new mid-year election change opportunities for 2020. They must notify eligible employees of any changes to their cafeteria plans made under the new IRS guidance. Plan amendments for these changes must be adopted by December 31, 2021, and can be retroactive to January 1, 2020, so long as the plan is operated in accordance with the IRS guidance. Employers should also coordinate with all applicable insurance carriers, stop-loss providers, and flexible spending account TPAs.

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