

IRS Issues Guidance Related to Changes in Elections, Grace Periods, and Carryovers

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As part of its ongoing efforts to help those who have been impacted by the health care and economic fallout from the Covid-19 pandemic, the IRS recently released two pieces of sub-regulatory guidance making it easier for participants to change their cafeteria plan elections and not forfeit funds in their flexible spending arrangements (FSAs). Notice 2020-29 provides relief for cafeteria plans in response to the current Covid-19 pandemic, and Notice 2020-33 provides a permanent increase to the carryover limit for health FSAs.

Due to the Covid-19 pandemic, many employees' reasonable expectations regarding medical and childcare expenses have significantly changed since they made their coverage elections for this year. For example, an employee may have waived health coverage for a child and now realized the child needs coverage because the child is home from college. Or, the employee may incur much less in medical and dependent care expenses this year because doctor, dentist, physical therapist, and childcare centers have been

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closed for months, with no signs of widespread or sustained re-openings in much of the country. On the other hand, an employee may incur significantly more in medical and dependent care expenses because he or she had Covid-19 or needed childcare because of school closures.

Notice 2020-29 provides some much-needed flexibility for mid-year election changes under an employer's cafeteria plan to help account for the fallout from the pandemic. It also extends the periods after which participants must forfeit FSA balances. This is welcome news for employers that want to be able to accommodate their employees' needs without running afoul of the cafeteria plan rules.

Unrelated to Covid-19, Notice 2020-33 provides additional welcome relief in the form of a modest increase in the carryover limit of unused amounts remaining as of the end of a plan year in a health FSA. Notice 2020-33 also clarifies the ability of a health reimbursement arrangement (HRA) to reimburse premium expenses incurred prior to the beginning of the plan year for coverage provided during the plan year.

We summarize the provisions of the two Notices below.

CAFETERIA PLAN MID-YEAR ELECTION CHANGES

An employer may allow employees to make prospective election changes during calendar year 2020 regarding employer-sponsored health coverage, health FSAs, and dependent care FSAs, regardless of whether the basis for the election change satisfies the existing criteria in the cafeteria plan regulations.¹ Notice 2020-29 explicitly permits employers to limit the period during which employees may make these mid-year election changes.

In particular, Notice 2020-29 permits an employer to allow employees to do the following:

- **Elect Employer-Sponsored Health Coverage:** Make a new election to enroll in employer-sponsored health coverage on a prospective basis if the employee initially declined to elect employer-sponsored health coverage.
- **Decline Employer-Sponsored Health Coverage:**
 - Revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different employer-

¹ Reg. §1.125-4. All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

sponsored health coverage on a prospective basis (including changing enrollment from self-only to family coverage).

o Revoke an existing election for employer-sponsored health coverage on a prospective basis, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer. An employer may rely on an employee's written attestation, unless the employer has actual knowledge that the employee is not, or will not be, enrolled in such other comprehensive health coverage. The Notice provides an example of an acceptable written attestation.

- **Changes to Health FSA Contributions:** Revoke an election, make a new election, or decrease or increase an existing health FSA election on a prospective basis.
- **Changes to Dependent Care FSA Contributions:** Revoke an election, make a new election, or decrease or increase an existing dependent care FSA election on a prospective basis.

Note while some of these changes may have already been permissible under the cafeteria plan change in election rules, the ability to drop health coverage and increase or decrease health FSA elections offers additional flexibility that was not previously available under the cafeteria plan rules. Notice 2020-29 specifically states that an employer may wish to consider limiting its potential financial exposure with respect to employees decreasing their FSA elections by limiting mid-year elections to amounts no less than amounts already reimbursed.

Notice 2020-29 does not define the term "employer-sponsored health coverage," but it appears for this purpose to include dental and vision coverage as well as medical coverage. The Notice makes it clear that it only encompasses benefits that are excludable from an individual's gross income under §105 or §106. Thus, the Notice does not apply to other benefits, such as life insurance or vacation buy/sell.

The changes permitted by Notice 2020-29 are effective on January 1, 2020, and last through December 31, 2020, provided that all election changes may be prospective only. Mid-year election changes only apply during calendar year 2020, and they apply to all employees eligible to participate in the cafeteria plan, not just to individuals effected by Covid-19.

All of these changes are optional, so an employer could choose to continue to apply their existing cafeteria plan rules pertaining to election changes rather than adding these new election change rules for 2020.

Additionally, an employer could choose to implement some of the changes permitted under the Notice but not all.

If an employer would like to allow these changes, it must amend its cafeteria plan to reflect these changes on or before December 31, 2021. The employer must, however, currently inform all employees eligible to participate in the cafeteria plan of the changes it will adopt.

EXTENDED CLAIMS PERIOD FOR HEALTH FSAs AND DEPENDENT CARE FSAs

An employer may permit employees to apply unused health and dependent care FSA amounts remaining as of the end of a grace period ending in 2020 or a plan year ending in 2020 to pay or reimburse health and dependent care expenses, respectively, incurred through December 31, 2020.

This extension of time is available both to cafeteria plans that have a grace period and cafeteria plans that have a carryover. A calendar year plan with a carryover will not gain any additional flexibility by adopting this rule, however, because the extended time period ends on December 31, 2020. Such a plan can, however, allow a carryover of unused amounts into the 2021 plan year under the general carryover rules.

Notice 2020-29 states that an individual is ineligible to contribute to a health savings account (HSA) during the extended claims period for a general purpose health FSA. Thus, employers that offer an HSA-compatible high deductible health plan (HDHP) should be mindful of this if they choose to extend the claims period. This is especially true if the grace period or plan year has already ended (e.g., for a calendar year plan with a grace period that ended on March 15, 2020) because employees may have already contributed to HSAs for past months.

Notably, Notice 2020-29 does **not** permit a cash out of unused FSA balances.

The changes permitted by Notice 2020-29 are effective for grace periods and plan years that end in 2020. The changes apply to all FSA plan participants, not just those affected by Covid-19.

The relief provided by Notice 2020-29 is optional, and may be of limited utility to a calendar year FSA plan, unless the plan has a grace period and a large number of participants forfeited money when that grace period ended.

An employer wishing to utilize the relief must amend its cafeteria plan and FSA plans to reflect these changes on or before December 31, 2021. The employer must, however, currently inform all employees eligible to participate in the cafeteria plan of the changes it will adopt.

Note that under final regulations the Department of Labor (DOL) and Treasury issued on April 29, 2020, plans are **required** to suspend the deadline for submitting claims until the end of the “Outbreak Period.”² This suspension, however, only applies to the deadline to submit the claim, not to incur the claim. Notice 2020-29 allows the employer to permissively extend the deadline to incur the claim.

HEALTH FSA CARRYOVERS

Notice 2020-33 provides a permanent increase to the maximum carryover amount for health FSAs from \$500 to an amount equal to 20% of the maximum salary reduction contribution under §125(i) for that plan year (currently \$2,750). This number is rounded to the next lowest multiple \$10. For carryovers from 2020 plan years, the maximum carryover amount is \$550.

The increase in carryover amount is welcome news, although participants may be disappointed that they cannot carry over their full remaining balance at the end of the 2020 plan year.

This change is effective beginning with carryovers from the 2020 plan year to the 2021 plan year. The carryover amounts will be increased each year, just like the maximum health FSA elective contribution amount.

As always, an employer may allow a carryover of any amount up to the maximum, but may elect a lower amount if it would like. An employer also could also choose not to allow any carryover or to use a grace period instead.

If an employer does want to increase its permitted carryover amount, it must amend its cafeteria plan and health FSA plan to reflect the increased carryover amount at any time on or before the last day of the plan year. For the 2020 plan year, the employer must adopt the amendment on or before December 31, 2021, but must currently notify participants of the increased amount.

Similar to the indexed health FSA contribution amount, a plan amendment can include language that references the indexed amount so that the employer does not need to amend its cafeteria plan each year to reflect the increased carryover amount.

² Extension of Certain Timeframes for Employee Benefit Plans, Participants, and Beneficiaries Affected by the COVID-19 Outbreak, 85 Fed. Reg. 26,351 (May 4, 2020).

HDHPs AND APPLICATION OF NOTICE 2020-15

Under earlier Covid-19-related relief issued on March 11, 2020,³ the IRS provided that a health plan that otherwise satisfies the requirements to be an HSA-eligible HDHP will not fail to be such an HDHP merely because the plan provides medical care services and items purchased related to testing for and treatment of Covid-19 prior to the satisfaction of the applicable minimum deductible. Notice 2020-29 clarifies that this relief applies retroactively with respect to reimbursements of expenses incurred on or after January 1, 2020.

Notice 2020-29 also clarifies what is included as testing for and treatment of Covid-19, consistent with DOL guidance. It specifies that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, respiratory syncytial virus (RSV), and any items or services required to be covered with zero cost sharing under the Families First Coronavirus Response Act⁴ (FFCRA) and the CARES Act⁵ are part of testing and treatment for COVID-19 for purposes of Notice 2020-15.

There has been some confusion with respect to the scope of services that are covered by the Notice 2020-15 relief, so this clarification is welcome news for plan sponsors and insurers.

This change is effective on January 1, 2020, and applies until the IRS issues future guidance. The change only applies with respect to Covid-19-related testing and treatment.

The requirement for plans to cover Covid-19 testing with no cost-sharing is mandatory, but plans can voluntarily cover Covid-19 treatment with no cost-sharing.

HDHPs AND CARES ACT TELEHEALTH PROVISION

The CARES Act provides a temporary safe harbor that allows an HSA-compatible HDHP to provide coverage for telehealth and other remote care services without a deductible or with a deductible below the minimum annual deductible.⁶ The safe harbor was effective beginning March 27, 2020, and applies to plan years beginning on or before December 31, 2021.

Notice 2020-29 applies the CARES Act provision retroactively to services provided on or after January 1, 2020.

To limit their participants’ potential exposure to Covid-19, many plans began allowing no-or low-cost

³ Notice 2020-15.

⁴ Pub. L. No. 116-127.

⁵ Pub. L. No. 116-136.

⁶ CARES Act, §3701.

telehealth services when the pandemic began, which was before March 27, 2020. This retroactive effective date to January 1, 2020, is welcome news for employers and insurers.

This change is effective on January 1, 2020, and applies through the end of 2021.

DATE PREMIUM CONSIDERED INCURRED FOR HRAs

Individual coverage HRAs may reimburse individual health insurance coverage and Medicare premiums, but only those incurred while the individual was a participant in the HRA plan. However, many individuals pay January premiums in December of the prior year. Notice 2020-29 provides that a plan may treat an expense for a premium for health insurance or Medicare coverage 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. Thus, for example, an individual coverage HRA with a calendar year plan year may reimburse a new participant's substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the participant paid the pre-

mium for the coverage prior to the date his or her participation began on January 1.

The Notice does not specify an effective date, so it presumably is May 12, 2020 (the date the IRS issued the Notice). It is unclear whether the Notice permits an HRA to reimburse the premiums that a new participant as of January 1, 2020, paid in December 2019 for coverage beginning in January 2020. This rule does not have an expiration date.

FURTHER CHANGES?

As employers and employees continue to adjust to the changes to their work and home lives as a result of Covid-19, additional questions are sure to arise and ongoing employee benefits will continue to require regular administration. The IRS has yet to publish final cafeteria plan regulations, and participants continue to advocate for full rollover of FSA funds, to list just two issues that continue to be top of mind for employee benefits professionals. We are hopeful that Notice 2020-29 and Notice 2020-33 will not be the last we will hear from the IRS on these issues in the coming months.