

Insights

IRS Provides Flexibility for Cafeteria Plans to Permit Mid-Year Election Changes, Extend FSA and DCAP Claims Periods

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Overview

On May 12, 2020, the IRS issued guidance in response to the COVID-19 pandemic which provides flexibility during calendar year 2020 for employer-sponsored health coverage, health flexible spending arrangements ("FSAs"), and dependent care assistance programs ("DCAPs"). **IRS Notice 2020-29** allows Section 125 cafeteria plans to permit eligible employees: (i) to make prospective mid-year election changes respecting group health plan coverage, FSAs and DCAPs; and (ii) to apply unused FSA and DCAP amounts at the end of the plan's grace period or plan year ending in 2020 to pay or reimburse medical care or dependent care expenses, respectively.

Further, the guidance provides that the CARES Act's temporary safe harbor for first-dollar HDHP coverage of telehealth or other remote care services may be applied retroactively to services provided on or after January 1, 2020 (an individual will not be disqualified from making tax-favored contributions to his or her health savings account ("HSA") due to such coverage).

Mid-Year Election Changes under Cafeteria Plans

Current Section 125 rules for cafeteria plans generally require an employee to make salary reduction elections prior to the plan year's start. These elections are irrevocable during the coverage period, with a few exceptions permitted under **Treas. Reg. § 1.125-4**. Cafeteria plans may adopt exceptions to the irrevocability rule provided by this regulation, permitting employees to make certain mid-year election revocations and changes in connection with a change in status or significant change in the cost of coverage. The IRS has recognized that the COVID-19 pandemic creates an extraordinary need for greater flexibility to make mid-year election changes than is currently permitted under the Section 125 regulations, and so issued Notice 2020-29.

The temporary relief under Notice 2020-29 allows an employer to amend its Section 125 cafeteria plan to allow employees to:

- (1) Make a new election for employer sponsored health coverage on a prospective basis (if the employee initially declined to elect employer-sponsored health coverage);
- (2) 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 on a prospective basis (including changing enrollment from self-only coverage to family coverage);
- (3) 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 health coverage not sponsored by the employer;
- (4) Regarding a health FSA, revoke an election, make a new election, or decrease or increase an existing election on a prospective basis; and
- (5) Regarding a DCAP, revoke an election, make a new election, or decrease or increase an existing election on a prospective basis.

With respect to (3) above, the guidance provides a sample attestation as to the employee's intent to enroll in other coverage, and states that employers may rely upon such an attestation unless the employer has actual knowledge to the contrary. Further, an employer is provided discretion to determine the extent of the election changes permitted under its Section 125 plan so long as it applies the relief in a nondiscriminatory manner. With respect to (4) health FSAs and (5) DCAPs, employers are permitted to limit mid-year elections to amounts no less than amounts already reimbursed.

Extended Claims Period for Health FSAs and DCAPs

Notice 2020-29 also permits an employer to amend its Section 125 cafeteria plan to allow employees to apply unused amounts remaining in an FSA or DCAP account as of the end of a grace period or plan year ending in 2020, to pay or reimburse medical care or dependent care expenses, respectively, incurred through December 31, 2020. Depending on which mechanism the cafeteria plan utilizes, if at all, the extension can be applied to either a carryover or a grace period.

The guidance provides useful examples of how the relief applies to cafeteria plans instituting the extended claims period in 2020. Plan sponsors should be aware that the extension of an FSA claims period may prevent an employee from making concurrent tax-favored contributions to an HSA. Nevertheless, employers and plan sponsors may consider allowing these changes under its FSA and or DCAP in order to account for the lack of availability of medical care (e.g. postponed elective surgeries) or dependent care that results from the COVID-19 pandemic.

Amendments to Cafeteria Plans

To implement the temporary relief of Notice 2020-29, the plan sponsor must adopt an amendment to its cafeteria plan document. The amendment may be adopted up until December 31, 2021, so long as the plan is administered accordingly in the interim. The amendment may be effective retroactively to January 1, 2020; though mid-2020 election changes may only be made on a prospective basis. Although the plan amendment adoption date may be deferred, notice of the amendment should be provided to employees as soon as possible, so they can make informed decisions about their cafeteria plan elections.

Conclusion

The IRS guidance provides much-needed flexibility to plan sponsors and employers as they continue to address the fluctuating workforce demands spurred by the COVID-19 pandemic. We anticipate that further guidance will continue to be issued throughout the coming weeks and months, so stayed tuned for more. If you would like more information about Notice 2020-29 or need assistance drafting a notice for plan participants, please contact **Bryan J. Gross, Alexander L. Mounts, Sharon B. Hearn** or another member of the Krieg DeVault **Employee Benefits & Executive Compensation Practice Group**. Also, please look to Krieg DeVault's **COVID-19 Resource Center** for posts and links addressing a number of legal and other issues related to COVID-19, including the CARES Act.