

The IRS Gives New Meaning to an “Election Year” by Significantly Increasing Cafeteria Plan Mid-Year Election Change Options

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The Internal Revenue Service (IRS) recently issued Notice 2020-29 and Notice 2020-33 to provide relief for employees participating in a Section 125 cafeteria plan. Although temporary, the changes will provide employees greater flexibility during this time of volatility to make mid-year election changes without the necessity of a specific change event in order to maximize their health coverage or revoke elections that otherwise may lead to forfeited benefits.

New Mid-Year Change Opportunities

Through a cafeteria plan, employees may elect to pay for certain qualified health or dependent care expenses on a pre-tax basis. Generally, such elections must be made prior to the first day of the plan year and may only be revised under limited circumstances. Pursuant to Notice 2020-29, employers have the option to implement the following election changes on a prospective basis for their participating employees. Such election changes may impact the employee’s salary deferral and benefit enrollment status. Specifically, the new guidance provides employees the opportunity to:

1. Enroll in employer-sponsored health coverage mid-year if an employee previously declined coverage.

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2. Enroll in a different health coverage option offered by the same employer (e.g., change from an HMO to a PPO, or move from single to family coverage).
3. Drop existing employer-sponsored health coverage 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.
 - The 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. A model attestation is provided in Notice 2020-29.
4. Make mid-year changes to initially enroll, increase, decrease or revoke health flexible spending arrangement (FSA) or dependent care assistance program (DCAP) elections.

All of the above changes to the cafeteria plan are optional. However, if the employer chooses to implement any of the above changes, an amendment to the cafeteria plan will need to be adopted on or before December 31, 2021. Importantly, the employer must currently inform all employees eligible to participate in the cafeteria plan of any adopted changes.

Note: If cafeteria plans have already been permitting the types of changes above, the guidance allows the plan to be amended retroactively to January 1, 2020.

Laner Insights: Although this guidance is certainly useful, employers should consider the following:

- The guidance refers to medical claims and FSA/DCAP claims. The guidance is silent as to whether mid-year changes may be made to other benefits such as dental and vision.
- Employers with fully-insured coverage or stop loss coverage will need to confirm that mid-year election changes will be permitted under the terms of the insurance policy before making any changes in response to this guidance. Adverse selection and underwriting concerns may prevent insurers from approving such changes.

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- Employers that sponsor self-insured health plans and/or health FSAs and DCAPs should coordinate any changes with their third party administrators to avoid potential claim administration problems.
- Regarding health FSAs, employers may limit their financial exposure by limiting the extent of a participant’s mid-year FSA contribution decreases to amounts no less than amounts already reimbursed to participants during the plan year.
- If the cafeteria plan is subject to the Employee Retirement Income Security Act (ERISA), the notice to employees of any changes will need to comply with ERISA disclosure rules.

Extended Claims Period for Health FSA and DCAP Benefits

The new guidance also allows a cafeteria plan to be amended to allow participants to “spend down” amounts that may otherwise be forfeited in 2020. Specifically, the guidance extends the period during which employees may incur expenses under a health FSA or DCAP from the end of any grace period ending in 2020 or a plan year ending in 2020 (i.e., a non-calendar year plan) to pay or reimburse expenses incurred through December 31, 2020. For example, a calendar year plan ending in 2019, with a grace period ending March 15, 2020, may be amended to allow any amounts available for the grace period to reimburse expenses incurred during the 2020 calendar year.

Note: This coverage extension is considered disqualifying coverage for persons enrolled in a High Deductible Health Plan (HDHP). For example, if a plan has an August 1, 2019 – July 31, 2020 plan year, and the plan is amended to permit unused general purpose FSA amounts to be spent down between August 1, 2020 – December 31, 2020, a person with an unused balance will not be eligible to contribute to a Health Savings Account (HSA) during the 2020 calendar year (unless the spend-down amount is modified to be HSA compatible). As such, employers will need to weigh the benefits of this change against the possibility that the change will disqualify the participant from contributing to an HSA.

This relief applies for the entire 2020 calendar year, but any elections made as a result of this guidance may only be made on a prospective basis.

Increased Health FSA Carryover Limit

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In Notice 2020-33, the IRS increased the limit on carryovers of unused health FSA contributions that may be carried forward into the next year. As a result, for 2020, the carryover limit will be increased from \$500 to \$550. The IRS accomplished this by tying the carryover limit to the maximum amount by which salary can be reduced for contribution to a health FSA. The carryover limit is 20% of that amount, and going forward can be indexed for inflation, which was not available prior to this guidance.

Note: If the cafeteria plan simply references the \$500 carryover limit without noting that such amount may be modified by the IRS, the cafeteria plan may need to be amended to account for the increased \$550 amount. This change is not temporary. However, the plan must still be amended to reflect the inflation adjusted limit. Any amendment to incorporate this change must be adopted no later than the last day of the first plan year beginning in 2021 (December 31, 2021 for calendar year plans).

Miscellaneous Clarifications

Finally, the IRS guidance clarified the following:

- The relief provided in IRS Notice 2020-15 (allowing coverage of COVID-19-related testing and related services prior to satisfying the deductible in an HDHP) applies with respect to reimbursements of expenses incurred on or after January 1, 2020.
- That coverage for any COVID testing or supply services required to be covered at no-cost under the FFCRA and the CARES Act will not impact HSA eligibility.
- That the exception for no cost telehealth and other remote care services applies to services provided on or after January 1, 2020, with respect to plan years beginning on or before December 31, 2021.
- That individual coverage health reimbursement arrangements (ICHRAs) may treat an expense for a premium for health insurance coverage as incurred on either (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 that a reimbursement of premium expenses that are incurred prior to the beginning of a plan year is a reimbursable expense (this will account for the fact that January insurance

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premiums generally are due and paid in December). It is unclear when this change is effective, so it is presumably May 12, 2020, the date the IRS guidance was issued.

Given these significant changes to cafeteria plans (along with prior cafeteria plan changes allowed under the CARES Act), plan sponsors are encouraged to discuss implementation strategies with their legal counsel and applicable service providers.