



IRS Provides More COVID-19 Relief: This Time for Cafeteria Plans

As part of its ongoing response to the coronavirus (COVID-19) outbreak, the IRS has released new guidance ([Notice 2020-29](#)) providing increased flexibility with respect to mid-year election changes under Section 125 cafeteria plans during the 2020 calendar year. The Notice also provides increased flexibility with respect to grace periods that will allow participants with unused amounts in their health or dependent care flexible spending accounts (FSAs) to apply those amounts to expenses incurred through December 31, 2020. Generally, employers may adopt the changes immediately (in some cases retroactive to January 1, 2020), so long as the plan is amended by December 31, 2021.

Mid-year Election Changes

Section 125 of the Internal Revenue Code and the regulations thereunder allow employers to offer employees a choice between cash and certain non-taxable benefits (such as employer-provided health plans, health care FSAs and dependent care reimbursement accounts) through a cafeteria plan. Generally, elections regarding such qualified benefits must be made prior to the first day of the plan year (which is often the calendar year), and cannot be changed during the plan year except as specifically permitted under the regulations, such as when the employee experiences a change in status or when there are significant changes in the cost of coverage. As a recent court case reminded us, however, cafeteria plans are not *required* to permit mid-year election changes, and employers may impose conditions on mid-year election changes that are less permissive than the regulations allow.

Notice 2020-29 provides temporary additional flexibility regarding mid-year election changes. Under this relief, plan sponsors who choose to do so may amend their plans to allow participants to make mid-year election changes (that are not otherwise permitted under the current regulations) during the remainder of the 2020 calendar year. Specifically, an employer may amend its cafeteria plan to allow any employee who is eligible to make salary reduction contributions under the plan to make prospective election changes (including an initial election) with respect to either (i) employer-sponsored health plan coverage, (ii) contributions to a health FSA, or (iii) contributions to a dependent care reimbursement account. These amendments may allow employees to take any of the following actions (regardless of the reason):

1. Make a new election for employer-sponsored health coverage on a prospective basis (if the employee initially declined such coverage);
2. Revoke an existing election for employer-sponsored health coverage, and make a new election to enroll in different health coverage offered by the employer;
3. Revoke an existing election for employer-sponsored health coverage, provided the employee attests that he/she is enrolled in, or will immediately enroll in, other health coverage; or
4. Revoke an election, make a new election, or decrease or increase an existing election under a health care FSA or a dependent care reimbursement account on a prospective basis.

Just as mid-year election changes are themselves optional, these enhancements are also optional. Employers are not required to adopt any of these enhancements, and those that do are not required to provide unlimited election changes. The employer can set reasonable parameters regarding the extent to which these expanded election changes are permitted, so long as the changes are applied on a prospective basis only, and do not result in a failure to comply with the Section 125 nondiscrimination rules.

Extended Claims Period for Health FSAs and Dependent Care Reimbursement Accounts

Under what is currently known as the “carryover” rule, a cafeteria plan may (but is not required to) permit the carryover of up to \$500 of unused amounts remaining in a health FSA as of the end of a plan year to pay or reimburse a participant for expenses incurred during the following plan year. Under a separate rule known as the “grace period” rule, a cafeteria plan may permit a participant to apply unused amounts in either a health FSA or a dependent care reimbursement account at the end of the year to pay expenses for those same qualified benefits during a period of up to 2 ½ months after the end of the plan year. For a health FSA, a plan may adopt either the carryover rule or the grace period, but not both.

Notice 2020-29 allows cafeteria plans to provide additional flexibility with respect to the use of unused amounts that remain in health and dependent care reimbursement accounts at the end of the plan year (or the end of the grace period). An employer may amend its cafeteria plan to permit employees to apply such unused amounts as of the end of a grace period (or the end of a plan year) ending in 2020 to pay or reimburse expenses incurred for the same type of benefit through the end of the 2020 calendar year (i.e., through December 31, 2020). For example, if a calendar year health FSA provided for a 2 ½ month grace period following its 2019 plan year, the employer could amend the plan to provide that any unused amounts in the FSA as of March 15, 2020 (the last day of the grace period) could be used to pay or reimburse the employee for health care expenses incurred through December 31, 2020. Similarly, an FSA with a non-calendar plan year ending in 2020 that allows for a \$500 carryover could be amended to allow any unused amounts (including amounts greater than \$500) to be used to pay or reimburse health expenses incurred during the remainder of the 2020 calendar year.

Plan Amendments

An employer that elects to provide the additional flexibility regarding mid-year election changes, or to provide additional time to apply unused amounts in a flexible spending account to pay or reimburse expenses for the remainder of the 2020 year, must adopt a plan amendment documenting the change to its plan. However, any

amendment for the 2020 plan year can be adopted as late as December 31, 2021, and may be effective retroactively to January 1, 2020, provided that the plan operates in accordance with the requirements of Notice 2020-29, and the employer notifies all plan participants of the changes to the plan.

Employer Considerations

Employers should carefully consider whether to adopt some, all or none of the changes permitted under Notice 2020-29, and whether to impose additional conditions or limitations on a participant's ability to make mid-year election changes or to have additional time to spend unused amounts in their FSAs. The additional flexibility, while generally advantageous for plan participants, may result in increased employer costs, as fewer employee contributions are likely to be forfeited under the "use it or lose it" rule, making less funds available to offset the employer's cost of expenses incurred by terminating employees that exceed their FSA contributions. The additional flexibility in mid-year changes could also lead to additional "adverse selection" with respect to employer-sponsored group health plans (a factor which has already been exacerbated by the recent DOL guidance giving employees additional time to elect and pay for COBRA coverage). Employers should seek legal advice before "blindly" adopting all of the flexibility afforded by Notice 2020-29.

If you have any questions about the legal requirements for cafeteria plans, or if you would like to discuss whether your plan should adopt any or all of these new options, please contact any of the attorneys in Spencer Fane's Employee Benefits practice group.

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