

IRS ISSUES SECTION 125 CAFETERIA PLAN RELIEF TO INCREASE EMPLOYER FLEXIBILITY DURING THE COVID-19 PANDEMIC

Hodgson Russ Employee Benefits Alert
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On May 12, 2020, the Internal Revenue Service (“IRS”) released two pieces of guidance providing increased flexibility with respect to Internal Revenue Code section 125 cafeteria plans (“Section 125 plans”). In response to the COVID-19 pandemic, Notice 2020-29 and Notice 2020-33 provide relief including expanded election opportunities, extended claims grace periods, and increased carryover allowances.

Executive Summary

- Notice 2020-29 allows employers to amend certain Section 125 plans to allow for mid-year elections and extended claims grace periods to benefit employees who may be impacted by the COVID-19 pandemic.
- Notice 2020-29 also builds upon other recently released IRS guidance on HDHPs, clarifying that the relief provided in such guidance applies retrospectively.
- Notice 2020-33 increases, from \$500 to \$550, the amount that can be carried forward to the following year when a balance remains in a health FSA at the end of the plan year.

Notice 2020-29

Notice 2020-29, found here, provides two forms of temporary relief that provide increased flexibility to employers administering certain Section 125 plans: (1) allowance of certain mid-year election changes and (2) an extended claims grace period.

Mid-Year Election Relief

Typically, elections under Section 125 plans must be made prior to the first day of the plan year and are irrevocable, unless the employee experiences a “change of status” event approved by the IRS regulations and the plan provides that mid-year elections may be made pursuant to those regulations.

In response to the COVID-19 pandemic, Notice 2020-29 permits employers to amend their Section 125 plans to allow employees to make mid-year elections whether or not they experiences a “change of status” event approved by the IRS

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regulations. Employers may amend their Section 125 plans to allow eligible employees to make prospective election changes to their health flexible spending accounts (“health FSAs”), dependent care flexible spending accounts (“dependent care FSAs”), and pre-tax premium deferrals for paying for employer-sponsored health coverage during calendar year 2020.

Employers may (but are not required to) amend their Section 125 plans to allow for any or all the following prospective mid-year elections:

- Allowing employees to make a new election for employer-sponsored health coverage on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage;
- Allowing employees to 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);
- Allowing employees to 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;
- Allowing employees to revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA on a prospective basis; and
- Allowing employees to revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care FSA on a prospective basis.

Extended Claims Grace Period

Under IRS rules, Section 125 plans may include a grace period for health FSAs and dependent care FSAs. If a Section 125 plan has a grace period, participants who did not utilize their full account balance by the end of the plan year, may continue to be reimbursed for eligible claims incurred during a short “grace period” following the end of the plan year. This grace period usually runs from the end of the plan year up to 2 months and 15 days after the end of the plan year. Because of the COVID-19 pandemic, employees are more likely to have unused amounts sitting in their Section 125 plans when the plan expires due to the unavailability of elective health procedures, child care, etc.

Notice 2020-29 provides an increased grace period during which unused amounts remaining in a Section 125 plan may be applied to pay or reimburse dependent care expenses. Specifically, it permits employers to amend their plans to allow employees to apply any unused amounts remaining in their plan as of the end of the normal plan year or grace period ending in 2020 to pay or reimburse expenses incurred through December 31, 2020. This extended grace period also applies to health FSAs with a carryover feature.

Unfortunately, this relief does not seem to benefit calendar year plans that do not have a grace period feature. Other plans, however, such as off-calendar year plans and calendar year plans with a grace period feature should be able to take advantage of this relief.

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Amendment and Notice Requirements

To implement the mid-year election relief or extended claims grace period relief described above (or both), employers must amend their Section 125 plans. Such amendments will be considered timely as long as they are made before December 31, 2021, as long as the amended Section 125 plans operate in accordance with the requirements of Notice 2020-29 and the employer informs all eligible employees of the plan changes that are implemented.

Clarifications of COVID-19 HDHP and HSA Developments

In addition to the relief outlined above, Notice 2020-29 makes two clarifications related to high deductible health plans (“HDHPs”) and health savings accounts (“HSAs”).

Notice 2020-15 permitted HDHPs to remain HDHPs, despite the fact that the health 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 Notice 2020-15 is applicable retrospectively, and applies to reimbursements of expenses incurred on or after January 1, 2020. Notice 2020-29 also provides that any items or services that are required to be covered at zero cost by the Families First Coronavirus Response Act (“FFCRA”) or Coronavirus Aid, Relief, and Economic Security (“CARES”) Act are considered to be “related to testing for and treatment of COVID-19.”

The CARES Act provided that telehealth and other remote care services are categories of coverage that are disregarded for the purposes of determining whether an individual who has other health plan coverage in addition to an HDHP is an eligible individual who may make tax-favored contributions to his or her HSA. Notice 2020-29 clarifies that this relief is applied retroactively to January 1, 2020, for plan years beginning on or before December 31, 2021.

Notice 2020-33

Participants in a Section 125 plan are generally not permitted to carry forward any unused amount remaining in the plan at the end of the applicable plan year or grace period. This is generally referred to as the “use-or-lose” rule. Notice 2013-17 liberalized the use-or-lose rule by providing a \$500 carryover of any unused health FSA amounts remaining as of the end of the plan year. This carryover does not count against or otherwise affect the indexed \$2,500 limit on salary reduction contributions applicable to each plan year.

Notice 2020-33, found here, increases the maximum amount of unused amounts in a participant’s health FSA as of the end of the plan year that may be carried over to the following plan year. Specifically, Notice 2020-33 increases this amount by \$50, making \$550 the total amount eligible for health FSA carryover into 2021. Unlike the changes under Notice 2020-29, this change is permanent, and is not specific to the COVID-19 pandemic.

In order to take advantage of the increased carryover limit outlined above, the Section 125 plan generally must be amended on or before the last day of the plan year from which the amounts are permitted to be carried over, and may be effective retroactively to the first day of that plan year. However, for calendar year plans wishing to apply the increased limit respecting the carryover of 2020 plan year amounts, the applicable amendment date is December 31, 2021.

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Next Steps

- Coordinate with Insurers and TPAs. Before amending the Section 125 plan, employers should contact their insurance, re-insurance, and third-party-claims administrators to confirm they are willing and able to accommodate this new guidance.
- Amend Section 125 Plan. Employers interested in allowing their employees to take advantage of some or all of these provisions will need to amend their Section 125 plans.
- Notify Participants. In addition, employers will need to consider how and when to notify their employees. Although the IRS guidance does not contain any new notice requirements, from a practical perspective, participants should be notified as soon as administratively practicable so that participants may make the best use of the new opportunities.

For any questions regarding how this guidance affects your employer-sponsored retirement and welfare benefit plans, please contact Michael Flanagan (716.848.1480) or Amy Walters (716.848.1481).

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