

IRS Notices Provide COVID-19 Relief Covering Section 125 Cafeteria Plans and Flexible Spending Account Benefit Plans

Many employers have sought to leverage or make changes to their employer-sponsored benefits to address economic and health-related burdens faced by their employees during the COVID-19 pandemic. Until now, however, employers with cafeteria plans qualified under Section 125 of the Internal Revenue Code (Code), and particularly those that offer flexible spending account benefits, have had little flexibility to enable employees to make changes without risking the tax-qualified status of these plans. On Tuesday, May 12, 2020, the U.S. Treasury Department and the Internal Revenue Service (IRS) issued a pair of notices providing much-needed relief and flexibility to both plan sponsors and participants. This update summarizes each respective notice. As noted in this update, employers that wish to implement the changes permitted under these notices must adopt a formal amendment to the cafeteria plan (including any other governing document for the flexible spending account benefits) to do so.

Under Notice 2020-29, Employers May Permit Employees to Make Midyear Election Changes Due to COVID-19

[Notice 2020-29](#) provides relief for midyear changes to pretax benefit elections made in relation to the COVID-19 pandemic. Typically, a participant's election under a cafeteria plan is irrevocable until the next open enrollment period unless they experience a midyear change in status event recognized under the Treasury rules (e.g., change in marital status or change in the number of eligible dependents). Employers are not required to permit midyear election changes under their cafeteria plans, but those that do must limit midyear election changes to those explicitly permitted under the Treasury rules.

Many employees and covered participants have experienced circumstances due to COVID-19 that are not addressed in the Treasury rules. Accordingly, Notice 2020-29 authorizes five new circumstances allowing midyear election changes under a cafeteria plan in the 2020 calendar year:

1. To permit an otherwise eligible employee who had declined the employer-sponsored health coverage to make a **midyear election to enroll in the health coverage prospectively on a pretax basis**.
2. To permit an employee currently enrolled in employer-sponsored health coverage to **change their election midyear and switch on a prospective basis to a different health plan option (or a different coverage tier)** offered under the employer's plan. Additionally, an employee may be permitted to enroll any eligible dependent who was not previously enrolled in the health coverage.
3. To permit an employee enrolled in employer-sponsored health coverage to **prospectively revoke their health coverage election midyear**, provided that the employee submits a written attestation that they are enrolled, or will immediately enroll, in other health coverage not sponsored by the employer. The notice provides template attestation language that an employer may rely on, absent actual knowledge that the employee is not enrolled in alternative health coverage.

Note: The notice guidance permits such health coverage election changes, regardless of whether the coverage is fully insured or self-funded. In considering whether to adopt an amendment permitting such midyear election changes, employers with fully insured health coverage should confirm that the insurance carrier agrees to implementing such changes, particularly new enrollments. Employers with self-funded health coverage should similarly confirm any third-party administrator and stop-loss carrier agrees on implementation and support.

4. To permit an otherwise eligible employee to make **prospective midyear election changes regarding the employer's healthcare flexible spending account (health FSA)** to (1) newly elect the health FSA, (2) revoke their health FSA election for all additional contributions remaining in the 2020 calendar year, or (3) otherwise increase or decrease their current health FSA election. Employers should be aware that permitting election changes with respect to a general-purpose health FSA could affect an individual's eligibility to contribute to a health savings account (HSA) and should inform participants accordingly. The employer has discretion as to the circumstances under which such midyear election changes would be permitted under the cafeteria plan for the remainder of 2020.

5. To permit an otherwise eligible employee to make **prospective midyear election changes to the employer's Dependent Care Assistance Program (DCAP)** to (1) newly elect the DCAP, (2) revoke their DCAP election for all additional contributions remaining in the 2020 calendar year, or (3) otherwise increase or decrease their current DCAP election. Similar amendment timing and considerations identified above for health FSA plan amendments apply to any such DCAP plan amendment.

Plan sponsors are not required to permit these midyear elections, nor are they required to allow unlimited changes for any midyear election changes that are permitted. They have discretion to determine the extent to which an employee qualifies for any permitted change and should also consider whether to limit the scope of any such amendment to account for amounts already reimbursed to employees pursuant to existing health FSA elections.

Under Notice 2020-29, Employers Also Can Extend Grace Periods to Incur Reimbursable Claims

Notice 2020-29 also permits plan sponsors to extend grace periods ending in 2020 (with respect to a 2019 plan year) to incur reimbursable expenses under a health FSA and DCAP through December 31, 2020. Plan sponsors may amend their plans to permit participants to use any leftover amounts that would have been forfeited at the end of the grace period for the 2019 plan year, to reimburse participants for qualifying medical expenses incurred (for health FSAs) and/or qualifying dependent care expenses incurred (for DCAPs) through the end of 2020. The IRS specifies in Notice 2020-29 that the extension of a grace period is considered an extension of coverage for plan years ending in 2020. As a result, implementing this relief for a general-purpose health FSA may affect an individual's eligibility to contribute to an HSA during the 2020 plan year.

Under Notice 2020-33, Employers Can Permit Increased Carryover Amounts for Health FSAs Beginning in 2020

[Notice 2020-33](#) increases the carryover limit for a health FSA from \$500 per plan year to \$550 per plan year beginning with the 2020 plan year. The general health FSA carryover limit will now be indexed to 20% of the maximum health FSA salary reduction contribution for the applicable plan year, so this carryover may change over time (with increases or reductions to the overall salary reduction limit). The plan sponsor continues to have the choice whether to implement a carryover and the amount permitted for the carryover, provided that the carryover is not concurrent with a grace period and the amount does not exceed the IRS limit.

Employers Must Adopt A Plan Amendment to Implement the Changes Permitted Under the Notices

An employer that wishes to permit these new midyear election changes, or to extend the period for a participant to incur a reimbursable health FSA or DCAP claim for the 2020 plan year, must adopt an amendment to the cafeteria plan (including any other governing document for the flexible spending account benefits) by December 31, 2021. For Section 125 cafeteria plans previously amended to permit midyear election changes for employer-sponsored health coverage, health FSAs, or DCAPs prior to the IRS's issuance of Notice 2020-29, any such amendment may be retroactively effective to January 1, 2020. In the interim the plan must be operated in accordance with the guidance provided in Notice 2020-29, as well as otherwise applicable plan terms and Code Section 125 requirements.

If a plan sponsor wishes to amend a Code Section 125 cafeteria plan to increase the health FSA carryover limit pursuant to IRS Notice 2020-33, the amendment must be adopted on or before the last day of the plan year from which amounts may be carried over. The amendment may be retroactive to the first day of that plan year.

Employers should consider, in evaluating whether to amend Section 125 cafeteria plans to allow for any of these changes, the needs of existing plan participants and non-participating employees affected by the COVID-19 pandemic. While IRS Notices 2020-29 and 2020-33 permit the changes described above, implementation of each such change requires a formal plan amendment and coordinating a summary of material modification for the health FSA at a minimum. Employers should consult with their insurance providers and health FSA and DCAP administrators prior to implementing any amendment to ensure that changes contained therein would be approved by the former and supported by the latter. In addition, employers should consult with legal counsel to coordinate drafting of plan amendments and participant notices, as well as review of other related considerations.

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