



COMPLIANCE ALERT



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The IRS Issues Optional Cafeteria Plan Relief and Indexes H-FSA Carryover Limits

Introduction

In response to the COVID-19 crisis, the IRS issued two notices that may affect how employers to administer certain aspects of their Cafeteria Plans. First, [Notice 2020-29](#) allows for temporary increased election change flexibility with respect to certain mid-year Cafeteria Plan elections. It also provides that the CARES Act rule allowing telemedicine coverage to be provided below the deductible of a HSA compatible high deductible health plan without compromising HSA eligibility is effective retroactively to January 1, 2020 and confirms that testing for influenza is part of COVID-19 testing and will also not be disqualifying coverage. Second, [Notice 2020-33](#) indexes the permitted Health-Flexible Spending Account (H-FSA) carryover amount from \$500 to \$550. This Alert is primarily focused on Notice 2020-29 and new optional election change flexibility.

Notice 2020-29

Elections under a Cafeteria Plan

A Cafeteria Plan is a funding vehicle created under § 125 or the Internal Revenue Code (Code) that allows employees to salary reduce to pay for certain qualified benefits on a pre-tax or tax favored basis. A critical condition of this tax advantage is that participant elections must be irrevocable for the period of coverage (generally the plan year) unless certain specific status change or election change events occur. Notice 2020-29 adds to the list of permitted status changes that an employer may choose to adopt through a Cafeteria Plan Document Amendment by creating new temporary permitted changes. In particular, an employer may amend its plan to:

- (1) Allow an employee who initially declined to elect employer-sponsored health coverage mid-year on a prospective basis.

Alliant note: This issue first arose when certain medical carriers offered a mid-year enrollment opportunity to employees who had previously declined coverage. The consensus was that if employers chose to allow these new elections premiums could be paid on a pre-tax basis under existing Cafeteria Plan election change rules. Specifically, the addition of required coverage without cost sharing for COVID-19 testing was a significant improvement of a benefit option. Many self-funded plans also considered allowing these elections in response to this offer by carriers. Given that this coverage change is no longer new, employer plan sponsors who would like to allow or continue to allow mid-year enrollment throughout the 2020 calendar year should consider adopting this change. Carrier or stop loss approval is recommended.

(2) Allow an employee to revoke an existing election for employer-sponsored health coverage and make a new election to enroll in a different benefit option sponsored by the same employer on a prospective basis (including changing enrollment from self-only coverage to family coverage).

Alliant note: Allowing employees to change benefit options and coverage tiers mid-year throughout the 2020 calendar year may create administrative challenges. Carrier or stop loss approval is recommended.

(3) Allow an employee 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.

Alliant note: Allowing employees to drop coverage mid-year throughout the 2020 calendar year could decrease employer plan costs. This new “drop” event is similar to an existing status change event that allows employees whose hours are reduced to below 30 per week but do not lose eligibility for benefits to drop coverage if they attest that they intend to enroll in other MEC. Employer plan sponsors should consider making this temporary change.

(4) Allow an employee to revoke an election, make a new election, or decrease or increase an existing election for a H-FSA on a prospective basis.

Alliant note: Employer plan sponsors should consider making this temporary change. Any amendment should note that election changes cannot reduce coverage amounts below amounts that have already been reimbursed.

(5) Allow an employee to revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program (DCAP) on a prospective basis.

Alliant note: The election change rules around DCAPs have always been very flexible, and can generally accommodate changes that are necessary to reflect changes in the need for child care or the cost or availability of childcare. If employers are concerned about whether employees are coming forward to request DCAP changes within the time allowed after a change to the need for child care or the cost or availability of childcare they may want to adopt this change to allow election changes at any time throughout the 2020 calendar year. Any amendment should note that election changes cannot reduce coverage amounts below amounts that have already been reimbursed.

Extended Claims Periods for H-FSAs and DCAPS

Notice 2020-29 also allows employers to amend their Cafeteria Plan to permit employees to apply unused amounts remaining in a H-FSA or a DCAP as of the end of a grace period ending in 2020 or a plan year ending in 2020 to reimburse expenses incurred through December 31, 2020. For practical

purposes this is relief for non-calendar year plans or for plans with a grace period ending in 2020 (grace periods are limited to 2.5 months following the end of the plan year – March 15 for a calendar year plan).

Example 1. An employer has a calendar year Cafeteria Plan with a H-FSA that provides for a grace period ending on March 15 immediately following the end of each plan year. The employer may amend the plan to permit employees to apply unused amounts remaining in an employee's H-FSA as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020.

Example 2. An employer has a Cafeteria Plan on a July 1 plan year with a H-FSA that allows a \$500 carryover. The employer amends the plan to adopt a \$550 (indexed) carryover beginning with the July 1, 2020 plan year and to adopt the temporary extended period for incurring claims with respect to the 2019 plan year. This allows claims incurred through December 31, 2020 (prior to January 1, 2021), to be paid with amounts from the 2019 plan year.

Alliant note: These extensions are available for both general purpose and limited purpose H-FSAs. Importantly, these extensions will extend the coverage period for a general purpose H-FSA and that can affect HSA eligibility. Employer plan sponsors should consider making this temporary change if DCAP or H-FSA balances are high and likely to result in forfeitures.

Plan Amendments

Employers are required to formally amend cafeteria plans if they chose to provide some or all of the relief available under Notice 2020-29. An amendment for the 2020 plan year must be adopted on or before December 31, 2021, and may be effective retroactively to January 1, 2020, provided the employer informs all employees eligible to participate in the Cafeteria Plan of the changes to the plan. Additional notice are also required under ERISA but could be combined for administrative ease.

HDHP Issues

Notice 2020-29 also includes important clarifying guidance regarding HDHPs and HSA eligibility. It confirms prior guidance that an HDHP will not fail to be an HDHP because it provides medical care services and items related to testing for and treatment of COVID-19 without cost-sharing below the applicable minimum deductible of a HDHP on or after January 1, 2020. It also clarifies that diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) are part of testing and treatment for COVID-19 and will not disqualify an HDHP. This was a coverage mandate under the families First Coronavirus response Act (FFCRA) and clarified under Notice 2020-15 and in subsequent DOL FAQs.

Next, Notice 2020-29 clarified that an otherwise eligible individual with coverage under an HDHP may also receive coverage for telehealth and other remote care services outside the HDHP and before satisfying the deductible of the HDHP and still contribute to an HSA. Significantly this was a change under the CARES Act, which was effective on enactment on March 27, 2020. However, the Notice provides that treatment of telehealth and other remote care services under the CARES Act applies retroactively with respect to services provided on or after January 1, 2020. This means that an otherwise eligible individual with coverage under an HDHP who also received coverage beginning

February 15, 2020 for telehealth before satisfying the deductible for the HDHP will not be disqualified from contributing to an HSA during 2020. Note that this telehealth exception as currently drafted only applies with respect to plan years beginning on or before December 31, 2021.

Notice 2020-33

In 2013 IRS amended existing rules that applied to H-FSAs to allow H-FSAs to offer carryovers of unused balances of up to \$500 remaining at the end of a plan year to be used for qualified medical expenses incurred in subsequent plan years (cannot be used with a grace period). Notice 2020-33 increases in the amount that can be carried over from one plan year to the next to \$550. Specifically, the maximum unused amount from a plan year starting in 2020 allowed to be carried over to the following plan year beginning in 2021 is \$550. This increase reflects indexing for inflation and parallels the indexing applicable to the limit on H-FSA salary reduction contributions (\$500 reflected 20% of the initial maximum salary reduction election of \$2,500). A Cafeteria Plan that is not drafted to reflect that the \$500 carryover amount will increase automatically as indexed will need to be amended to reflect this increase. An amendment to increase the carryover limit must be adopted on or before the last day of the plan year from which amounts may be carried over and may be effective retroactively to the first day of that plan year. This means that 2020 Cafeteria Plans must be amended before the last day of their 2020 plan year to allow increased carryovers to a 2021 plan year.

Conclusion

We will continue to monitor this very fluid situation and provide the latest information on the COVID-19 pandemic, including emerging legal challenges and practical recommendations. Our full suite of resources is available on [Alliant's COVID-19 Resource Page](#).

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