

IRS provides cafeteria plan flexibility and high deductible health plan information

Notice 2020-29, 2020-22 IRB

In a Notice, **IRS** has added to the situations in which a **cafeteria plan** may allow employees to make mid-year elections, allowed more flexibility with respect to health flexible spending accounts (health FSAs) and dependent care assistance programs under a **cafeteria plan**, and provided several rules with respect to high deductible health **plans** (HDHPs).

Background—elections under a cafeteria plan. Code Sec. 125(d)(1) defines a **cafeteria plan** as a written **plan** maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits.

Elections regarding qualified benefits under a **cafeteria plan** generally must be irrevocable and must be made prior to the first day of the **plan** year, except as provided under Reg. § 1.125-4. Reg. § 1.125-4 **provides** that a **cafeteria plan** may permit an employee to revoke an election during a period of coverage and to make a new election under certain circumstances, such as if the employee experiences a change in status or there are significant changes in the cost of coverage. Code Sec. 125 does not require a **cafeteria plan** to permit the mid-year election changes allowed under Reg. § 1.125-4.

Background—health FSAs and dependent care assistance programs under cafeteria plans. A **cafeteria plan** may permit the carryover of unused amounts remaining in a health FSA as of the end of a **plan** year to pay or reimburse a participant for medical care expenses incurred during the following **plan** year, subject to the carryover limit (currently \$550). This is sometimes referred to as the carryover rule. (Notice 2013-71, 2013-47 IRB 532, and Notice 2020-33, 2020-22 IRB (see here)).

A **cafeteria plan** may permit a participant to apply unused amounts (including amounts remaining in a health FSA or dependent care assistance program) at the end of a **plan** year to pay expenses incurred for those same qualified benefits during the period of up to two months and 15 days immediately following the end of the **plan** year. This is sometimes referred to as the grace period rule. (Notice 2005-42, 2005-1 C.B. 1204, and Prop Reg § 1.125-1(e)) For a health FSA, a **cafeteria plan** may adopt a carryover or a grace period (or neither), but may not adopt both features. (Notice 2013-71)

Background—health FSAs and health savings accounts. Code Sec. 223 permits eligible individuals to establish and contribute to health savings accounts (HSAs). Pursuant to Code Sec. 223(c)(1)(A), an eligible individual is, with respect to any month, any individual if (i) such individual is covered under an HDHP as of the first day of such month, and (ii) such individual is not, while covered under an HDHP, covered under any health **plan** which is not an HDHP, and which **provides** coverage for any benefit which is covered under the HDHP.

An HDHP is a health **plan** that satisfies the minimum annual deductible requirement and maximum out-of-pocket expenses requirement under Code Sec. 223(c)(2)(A).

Coverage by a general purpose health FSA is coverage by a health **plan** that disqualifies an otherwise eligible individual from contributing to an HSA, although coverage by a limited purpose health FSA does not do so. (Rev Rul 2004-45, 2004-1 C.B. 971)

IRS notes effects of COVID-19 on cafeteria plans. Due to the nature of the public health emergency posed by COVID-19: a) some employees may have an increase or decrease in medical expenses due to unanticipated changes in the need for or availability of medical care and may wish to increase or decrease amounts in their health FSAs; b) some employees may have an increase or decrease in the need for dependent care assistance due to the unanticipated closure of schools and child care providers and changes to the employee's work location or schedule; and c) employees may be more likely to have unused health FSA amounts or dependent care assistance program amounts (or have larger unused health FSA amounts or dependent care assistance program amounts) as of the end of **plan** year, or grace periods.

In response, **IRS** has increased flexibility in **cafeteria plan** rules as follows:

Elections under a cafeteria plan. The Notice **provides** temporary flexibility for **cafeteria plans** to permit employees to make certain prospective mid-year election changes for employer-sponsored health coverage, health FSAs, and dependent care assistance programs during calendar year 2020 that the **plan** chooses to permit.

Specifically, an employer, in its discretion, may amend one or more of its **cafeteria plans** to allow each employee who is eligible to make salary reduction contributions under the **plan** to make prospective election changes (including an initial election) during calendar year 2020 regarding employer-sponsored health coverage, a health FSA, or a dependent care assistance program, regardless of whether the basis for the election change satisfies the criteria set forth in Reg. § 1.125-4.

In particular, an employer may amend one or more of its **cafeteria plans** to allow employees to: (1) make a new election for employer-sponsored health coverage on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage; (2) 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); (3) 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; (4) revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA on a prospective basis; and (5) revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program on a prospective basis.

To accept an employee's revocation of an existing election for employer-sponsored health coverage, the employer must receive from the employee an attestation in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer.

The Notice **provides** an example of an acceptable written attestation.

An employer utilizing this relief under Code Sec. 125 is not required to **provide** unlimited election changes but may, in its discretion, determine the extent to which such election changes are permitted and applied, provided that any permitted election changes are applied on a prospective basis only, and the changes to the **plan's** election requirements do not result in failure to comply with the nondiscrimination rules applicable to **cafeteria plans**.

Changes to the **plan** may also implicate other applicable laws, such as notice requirements under Title I of the Employee Retirement Income Security Act of 1974, with which any changes should comply. With respect to mid-year election changes for employer-sponsored coverage, this relief applies to both employers sponsoring self-insured **plans** and employers sponsoring insured **plans**. With respect to health FSAs, this relief applies to all health FSAs, including limited purpose health FSAs compatible with HSAs.

Effective date. This relief may be applied retroactively to periods prior to the issuance of the Notice and on or after January 1, 2020, to address a **cafeteria plan** that, prior to the issuance of the Notice, permitted mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs that otherwise are consistent with the requirements for the relief provided in the Notice.

Extended claims period for FSAs and dependent care assistance programs. The Notice also **provides** flexibility for a **cafeteria plan** to **provide** an extended period to apply unused amounts remaining in a health FSA or dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses.

Specifically, an employer, in its discretion, may amend one or more of its **cafeteria plans** to permit employees to apply unused amounts remaining in a health FSA or a dependent care assistance program as of the end of a grace period ending in 2020 or a **plan** year ending in 2020 to pay or reimburse expenses incurred for the same qualified benefit through December 31, 2020.

For example, if an employer sponsors a **cafeteria plan** with a health FSA that has a calendar year **plan** year and **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 health FSA as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020.

The extension of time for incurring claims is available both to **cafeteria plans** that have a grace period, and **plans** that **provide** for a carryover, notwithstanding Notice 2013-71, which otherwise continues in effect and **provides** that health FSAs can either adopt a grace period or **provide** for a carryover amount but cannot have both.

Effect of extended claims on HSAs. The extension of the period for incurring claims that may be reimbursed by the health FSA is an extension of coverage by a health **plan** that is not an HDHP for purposes of determining whether an eligible individual qualifies to make contributions to an HSA (except in the case of an HSA-compatible health FSA, such as a limited purpose health FSA). Thus, an individual who had unused amounts remaining at the end of a **plan** year or grace period ending in 2020 and who is allowed an extended period to incur expenses under a health FSA pursuant to a **plan** amended in accordance with the Notice will not be eligible to contribute to an HSA during the extended period (except in the case of an HSA-compatible health FSA).

Effective date. The relief set forth in the Notice may be applied on or after January 1, 2020 and on or before December 31, 2020, provided that any elections made in accordance with the Notice apply only on a prospective basis.

Plan amendments required. An employer that decides to amend one or more of its **cafeteria plans** to **provide** for mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs in a manner consistent with the Notice or to **provide** for an extended period to apply unused amounts remaining in a health FSA or a dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses in a manner consistent with the Notice must adopt a **plan** amendment. In addition, an employer that decides to amend its health FSA to **provide** for an increase in the carryover of unused amounts to the following year in a manner consistent with Notice 2020-33, for the 2020 **plan** year or **plan** years thereafter, must adopt a **plan** amendment.

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 that the **cafeteria plan** operates in accordance with the Notice or Notice 2020-33 or both, as applicable, and the employer informs all employees eligible to participate in the **cafeteria plan** of the changes to the **plan**.

HDHP clarifications. Notice 2020-15, 2020-14 IRB 559, **provides** that a health **plan** that otherwise satisfies the requirements to be an HDHP under Code Sec. 223(c)(2)(A) will not fail to be an HDHP merely because 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.

The Notice clarifies that the relief provided in Notice 2020-15 applies with respect to reimbursements of expenses incurred on or after January 1, 2020. The Notice further clarifies that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus and any items or services required to be covered with zero cost sharing under section 6001 of the Families First Coronavirus Response Act (P.L. 116-127), as amended by the CARES Act, are part of testing and treatment for COVID-19 for purposes of Notice 2020-15.

As added by the CARES Act, Code Sec. 223(c)(2)(E) allows HSA-eligible HDHPs to cover telehealth and other remote care services without a deductible or with a deductible below the minimum annual deductible otherwise required by Code Sec. 223(c)(2)(A). Section 3701 of the CARES Act also amends Code Sec. 223(c)(1)(B)(ii) to include telehealth and other remote care services as categories of coverage that are disregarded for 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 under Code Sec. 223. The amendments to Code Sec. 223 under section 3701 of the CARES Act are effective March 27, 2020 and apply to **plan** years beginning on or before December 31, 2021.

The Notice **provides** that treatment of telehealth and other remote care services under section 3701 of the CARES Act applies with respect to services provided on or after January 1, 2020, with respect to **plan** years beginning on or before December 31, 2021. Therefore, for example, an otherwise eligible individual with coverage under an HDHP, who also received coverage beginning February 15, 2020 for telehealth and other remote care services under an arrangement that is not an HDHP and before satisfying the deductible for the HDHP, will not be disqualified from contributing to an HSA during 2020.

References: For **cafeteria plans**, see FTC 2d/FIN ¶ H-2401; United States Tax Reporter ¶ 1254.

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