Agency Guidance – IRS Notices Announce Increased Flexibility for Certain Plans

Issue Date: May 13, 2020

The Internal Revenue Service (IRS) issued two notices to assist with the nation's response to the 2019 Coronavirus outbreak. The first notice increases "*flexibility with respect to mid-year elections under a §125 cafeteria plan during calendar year 2020 related to employer-sponsored health coverage, health Flexible Spending Arrangements (health FSAs), and dependent care assistance programs (DCAPs). This notice also provides increased flexibility with respect to grace periods to apply unused amounts in health FSAs to medical care expenses incurred through December 31, 2020, and unused amounts in dependent care assistance programs to dependent care expenses incurred through December 31, 2020.*" Finally, this notice clarifies that recently announced exemptions for high deductible health plans (HDHPs) to remain HSA qualified apply retroactively to January 1, 2020.

The second notice increases "*the carryover limit (currently $500) of unused amounts remaining as of the end of a plan year in a health Flexible Spending Arrangement (health FSA) under a § 125 cafeteria plan that may be carried over to pay or reimburse a participant for medical care expenses incurred during the following plan year… Second, this notice clarifies the ability of a health plan to reimburse individual insurance policy premium expenses incurred prior to the beginning of the plan year for coverage provided during the plan year."*

IRS Notice 2020-29

This notice announces three changes, discussed in more detail below.

1. Increased Flexibility in Permitted Mid-year Election Changes for Employer-Sponsored Health Coverage, Health FSAs, and DCAPs
2. Extended Claims Period for Health FSAs and DCAPs
3. Retroactive Application of HDHP Exemptions

This relief applies only to calendar year 2020. Further, while midyear changes permitted in accordance with this new relief are permitted only on a prospective basis, the relief itself applies retroactively to January 1, 2020. In other words, the notice clarifies that changes made before this relief was released (back to January 1, 2020), which otherwise would have been a violation of the irrevocability rule under Section 125, will also be considered compliant if they comply with this new guidance.

The notice also clarifies that employers are able to use their discretion when determining the extent to which they will permit midyear changes or extended claims periods in accordance with this new guidance. To this point, employers may want to consider adverse selection consequences potentially associated with permitting certain changes. Further, allowing extended time to use unused health FSA amounts through the end of 2020 may impact HSA eligibility. However, if the employer does intend to permit changes in accordance with this guidance, they will be required to notify plan participants and amend plan documents. Plan documents should be amended by December 31, 2021, and are permitted to have a retroactive effect back to January 1, 2020.

Increased Flexibility in Permitted Mid-year Election Changes

The IRS recognizes that the scenarios that currently permit midyear pre-tax election changes as set forth in Section 125 of the tax code "*may not apply with respect to election changes that employees may wish to request for employer-sponsored health coverage, health FSAs, and dependent care assistance programs for reasons related to the COVID-19 public health emergency.*" For example, but for this added flexibility, changes would not be permitted arising from an employee's increase or decrease in medical expenses "*due to unanticipated changes in the need for or availability of medical care*." In response, the IRS has provided temporary flexibility for plan sponsors who wish to permit employees to make changes outside of the scenarios that traditionally permit a midyear election change.

"In particular, an employer may amend one or more of its § 125 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."*

As reflected in the list above, there are more conditions associated with when an employee is permitted to change their enrollment in employer-sponsored health coverage than are required of changes made to health FSAs or DCAPs. In other words, this notice provides for greater flexibility to change elections under health FSAs and DCAPs, than for changes to employer-sponsored health coverage. For example, an employee is permitted to terminate their employer-sponsored health coverage only if they will be enrolling in other health coverage not sponsored by the employer. Therefore, the notice provides a model attestation to use when employees request to terminate the employer's coverage in order to enroll in other health coverage not sponsored by the employer.

Extended Claims Periods for Health FSAs and DCAPs

"An employer may amend its § 125 cafeteria plan 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 through December 31, 2020." In other words, non-calendar year plans ending in 2020, or calendar year plans with a grace period ending in 2020, can allow employees continued access to unused amounts until December 31, 2020. However, employers should keep in mind that extending the health FSA claims period may result in HSA ineligibility for employees during that time. If the health FSA is a general purpose FSA, and an employee has amounts remaining in the FSA at the end of the plan year or grace period that ends in 2020, the employee will be ineligible to contribute to an HSA for all of 2020 if the employer extends the claims period until December 31, 2020.

This relief is available for both general purpose and limited purpose health FSAs. In addition, health FSAs utilizing either a grace period or a carryover are permitted to offer this extended claims period.

Retroactive Application of HDHP Exemptions

Pursuant to § 223(c)(1)(A), an individual is HSA eligible for a given month 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.

A *"telemedicine arrangement generally constitutes a health plan or insurance that provides coverage before the minimum annual deductible is met, and provides coverage that is not disregarded coverage or preventive care, which would generally disqualify an otherwise eligible individual from contributing to an HSA. However, section 3701 of the CARES Act amended § 223 of the Code to temporarily allow HSA-eligible HDHPs to cover telehealth and other remote care services."*

Further, *"Notice 2020-15 provides that a health plan that otherwise satisfies the requirements to be an HDHP 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."*

This notice clarifies that the relief provided in section 3701 of the CARES Act regarding telemedicine arrangements and the relief provided in Notice 2020-15 regarding expenses related to testing for and treatment of COVID-19, applies with respect to reimbursements of expenses incurred on or after January 1, 2020.

"*This notice further clarifies that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) and any items or services required to be covered with zero cost sharing under section 6001 of the Families First Coronavirus Response Act as amended by the CARES Act, are part of testing and treatment for COVID-19 for purposes of Notice 2020-15.*" In other words, an HDHP will not lose qualified status for covering any expenses required to be covered with zero cost sharing under the FFCRA.

IRS Notice 2020-33

FSA Carryover Amounts

When the IRS originally announced the ability of plan sponsors to permit empoyees to carry over unused amounts into the next plan year under a health FSA, the maximum amount permitted to be carried over was $500. This reflected 20% of the annual FSA election limit at the time ($2,500). Since that time there has been no adjustment to the maximum carryover amount, despite the fact that the election limit has increased with inflation. This notice increases the maximum $500 carryover amount for a plan year to an amount equal to 20 percent of the maximum salary reduction contribution for that plan year. Therefore, "*the maximum unused amount from a plan year starting in 2020 allowed to be carried over to the immediately following plan year beginning in 2021 is $550 (20 percent of $2,750, the 2020 FSA election limit).*"

As with changes made under IRS Notice 2020-29, plan documents should be amended by December 31, 2021, and are permitted to have a retroactive effect to January 1, 2020.

Timing for Reimbursements by Health Plans

In general, plans are prohibited from reimbursing an expense incurred in a prior plan year. This prohibition is referred to as the prohibition on deferred compensation and comes from Section 125 of the tax code. However, "*medical care expenses are treated as incurred when the covered individual is provided the medical care that gives rise to the expense, and not when the amount is billed or paid*." Therefore, this notices clarifies that individual coverage HRAs (ICHRAs) are permitted to "*reimburse a substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium for the coverage prior to the first day of the plan year.*"

Summary

The 2019 Coronavirus outbreak has resulted in employees having extreme difficulty predicting medical or childcare expenses. In these notices, the IRS has provided some relief for employers looking to assist employees with changing circumstances. If employers decide to implement any of the permitted changes in these notices, they should be aware of the potential plan consequences. In addition, they should be prepared to make the required plan amendments and to communicate such changes to affected employees. This summary provides just some of the highlights from both notices. For complete information on the new guidance, we recommend reading the notices at the links below.

IRS Notice 2020-29 – **https://www.irs.gov/pub/irs-drop/n-20-29.pdf**

IRS Notice 2020-33 – **https://www.irs.gov/pub/irs-drop/n-20-33.pdf**