BRACEWELL

INSIGHTS

IRS Eases Restrictions on Cafeteria Plans and FSAs in Response to COVID-19

May 14, 2020

*By: **Scott C. Sanders** and **Matthew B. Grunert***

On May 12, 2020, the Internal Revenue Service issued Notice 2020-29, which allows employers to make temporary changes to section 125 cafeteria plans. The permitted changes include giving employees more flexibility to make mid-year election changes, and extending the claims period for health and dependent care flexible spending arrangements (FSAs).

Mid-Year Election Changes
Under the cafeteria plan rules, an employee's election under a cafeteria plan for a plan year generally cannot be changed or revoked during the year unless a "change in status" event (as defined under IRS regulations) occurs and the terms of the cafeteria plan allow for such change. The relief provided under Notice 2020-29 is intended to address changes in circumstances that many employees are facing due to the 2019 Novel Coronavirus (COVID-19) that do not otherwise qualify as change in status events.

Under Notice 2020-29, a cafeteria plan may permit employees who are eligible to make salary reduction contributions under the plan to:

1. For employer-sponsored health coverage, (1) make a new election on a prospective basis if the employee initially declined to elect coverage; (2) revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis; and (3) revoke an existing election 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; and

2. Revoke an election, make a new election, or decrease or increase an existing election applicable to a health or dependent care FSA on a prospective basis.

It should be noted that employers may amend their cafeteria plans to a lesser extent than permitted by Notice 2020-29. For example, an employer could amend its plan to limit election changes for employer-sponsored health coverage to circumstances in which an employee's coverage will be increased or improved as a result of the election, such as changing from self-only to family coverage.

Extended Claims Period
Under a "carryover" rule, a cafeteria plan may permit the carryover of unused amounts remaining in a health FSA as of the end of a plan year to reimburse an employee for medical

care expenses incurred during the following plan year, subject to a limit (currently $550, as increased pursuant to IRS Notice 2020-33 (also issued on May 12, 2020)).

Under a “grace period” rule, a cafeteria plan may permit an employee to apply unused amounts remaining in a health FSA or dependent care FSA at the end of a plan year to pay expenses incurred for qualified benefits during the period of up to two months and 15 days immediately following the end of the plan year.

Under Notice 2020-29, an employer may amend its cafeteria plan to permit employees to apply unused amounts remaining in an FSA 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 qualified benefits through December 31, 2020. The extension of time for incurring claims is available both to cafeteria plans that have a grace period, and cafeteria plans that provide for a carryover. Notice 2020-29 does not change the rule that a health FSA can provide for either a grace period or a carryover amount, but cannot have both.

An employer is permitted, but not required, to amend its cafeteria plan to provide for these temporary changes. To the extent the changes are implemented, the cafeteria plan will need to be amended (the amendment can be adopted retroactively, as late as December 31, 2021), and employees should be notified of the changes. Employers wanting to implement the changes allowed by Notice 2020-29 should coordinate the changes with their insurers and third-party administrators and take steps to adopt timely amendments to their cafeteria plan documents.