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ALERTS

Relaxed Rules For Mid-year Election Changes And More Time To Use It Without Losing It For Some Flexible Spending Accounts

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Highlights

Due to COVID-19, the IRS has relaxed mid-year election changes for employer-provided health coverage and flexible spending accounts during 2020

Flexible spending accounts with grace periods or plan years ending in 2020 may permit reimbursements for expenses incurred through Dec. 31, 2020

Implementing the relaxed rules could place financial burden on companies

The IRS recently relaxed the election change rules applicable to Internal Revenue Code Section 125 cafeteria plans (Section 125 Plans) for employer-sponsored health coverage, health flexible spending accounts and dependent care flexible spending accounts in IRS Notice 2020-29 (Notice).

For health flexible spending accounts and dependent care flexible spending accounts with grace periods or non-calendar year plan years ending in 2020, the Section 125 Plan may be amended per the Notice to

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allow more time for participants to use amounts in those accounts as of the end of the grace period in 2020 or end of the plan year in 2020 for expenses incurred through Dec. 31, 2020.

The Notice also clarifies that previous relief for high-deductible health plans covering expenses related to COVID-19 and telehealth services, without first satisfying the deductible, may be applied retroactively to January 1, 2020.

Relaxed Mid-Year Election Changes

The Notice provides temporarily more flexibility for election changes under Section 125 Plans during the 2020 calendar year for employer-provided health plan coverage, health flexible spending accounts and dependent care flexible spending accounts, effective as of January 1, 2020. The reason for the increased flexibility expressed by the IRS in the Notice is the COVID-19 public health emergency may have created unanticipated changes in health expenses and dependent care expenses for employees. Allowing employees more flexibility for making election modifications would accommodate these unexpected changes. The rules do not require Section 125 Plans to offer mid-year election changes generally or the more flexible election changes from the Notice. However, any permitted election changes during the plan year are required to be set forth in the Section 125 Plan document.

Section 125 of the Internal Revenue Code establishes the framework for Section 125 Plans, including the election of benefits before the plan year starts and prohibiting any changes to those elections during the plan year, unless the employee has an identified change in status event. A Section 125 Plan provides the employee with a choice to receive taxable compensation in a paycheck or a pre-tax qualified benefit, like an employer-provided health plan, health flexible spending account or dependent care flexible spending account.

Typically, there are strings attached to the pre-tax advantage offered by Section 125 Plans. For instance, employees need to make elections for the benefits before the first day of the plan year (or within 30 days of being hired), and employees may not change their benefit choices during the plan year unless the employee or a dependent has a specified change in status event (*e.g.*, change in employment status, number of dependents, marital status, dependent eligibility, residence or worksite, *etc*.).

The Notice loosens some of those strings attached. For group health plan and flexible spending account election changes during the 2020 calendar year, the Notice states:

- To modify elections, the employee does not need to have the typical change in status events (*i.e.*, change in employment status, number of dependents, marital status, dependent eligibility, residence or worksite, *etc.*)
- Changes to elections will need to be prospective
- The eligible employees and participants will need to be informed of the new plan design that now permits temporary flexible election changes

The Section 125 Plan document will need to be amended for the new, more flexible election changes. The more flexible election options for employer-sponsored health coverage during 2020 include allowing:

- Employees who previously declined health coverage to enroll in health coverage
- Employees to discontinue one medical benefit option and enroll in another medical benefit option offered by the plan (i.e., indemnity option to high deductible health plan option, HMO to PPO, high deductible health plan option to basic medical option with health reimbursement account)
- Employees to end health coverage under their employers' plans if the employees certify that they enrolled or immediately will enroll in other health coverage (the Notice includes a sample certification)

For mid-year election changes related to employer-sponsored health coverage, the relief in the Notice applies to both employers that sponsor self-insured health plans and employers that sponsor insured health plans.

According to the Notice, a Section 125 Plan offering health and dependent care flexible spending accounts may be amended to permit employees and participants to stop, start, increase, or decrease contributions to the flexible spending account. The Section 125 Plan, however, could be designed to prohibit discontinuing or reducing contributions to an amount less than the expenses that have been paid from the participant's flexible spending account.

The relief in the Notice applicable to health flexible spending accounts extends to all health flexible spending accounts, including limited purpose flexible spending accounts compatible with health savings accounts.

More Time to Use It Without Losing It

A flexible spending account designed with a grace period or plan year ending in 2020 may be amended, per the Notice, to extend the time period during which participants may incur expenses eligible for reimbursement through Dec. 31, 2020.

Under the current rules, a flexible spending account offered through a Section 125 Plan may include a grace period to incur expenses following the plan year. Without the grace period feature, eligible expenses need to be incurred during the plan year and submitted for reimbursement from the flexible spending account within a short period of time after the plan year ends.

Unused amounts remaining in the flexible spending account at the end of the plan year are forfeited by the participants, which is often referred to as "the use it or lose it rule." As an alternative, a flexible spending account with a grace period allows participants to incur expenses for two months and 15 days after the plan year ends and receive reimbursement for those expenses from the prior plan year's flexible spending account contributions. Any unused amounts at the end of the grace period immediately following the plan year are forfeited.

For example, if the participant contributed $2,000 to a flexible spending account with a grace period for the 2019 calendar year and had a 2019 account balance of $1,000 remaining at the end of 2019, the participant could continue to incur expenses until the end of the grace period, March 15, 2020, and submit these 2020 expenses for reimbursement from the 2019 flexible spending account balance of $1,000.

If the plan sponsor amends the flexible spending account with the grace period as permitted by the Notice, the participant could incur expenses until Dec. 31, 2020 (rather than March 15, 2020) and submit those expenses for reimbursement from the 2019 contributions.

Similar relief is permitted for flexible spending accounts with non-calendar year plan years that end in 2020 (e.g., a July 1, 2019, to June 30, 2020, plan year) and claims may be incurred through Dec. 31, 2020.

Making Timely Amendments to Section 125 Plans

An employer that decides to make the changes to its Section 125 Plan permitted in the Notice, or to increase the health flexible spending account carryover amount to $550 for the 2020 plan year as allowed in Notice 2020-33, will need to adopt the plan amendment in a timely manner.

A Section 125 Plan amendment for the 2020 plan year is considered timely if adopted on or before Dec. 31, 2021, and may be effective retroactively to Jan. 1, 2020, provided that the Section 125 Plan is operated in accordance with the terms of the amendment and the employer informs all employees eligible to participate in the Section 125 Plan of the changes to the plan. Plan amendments must be limited to the terms described in the guidance and may not be more expansive.

Practical Considerations for Section 125 Plan Amendments

Before making plan design decisions, employers will need to consider the flexibility offered to employees through each change and the potential financial exposure. For example, with respect to any mid-year election change in contributions to a health flexible spending account, an employer should consider whether it wants to allow employees to increase the amount reimbursable under a health flexible spending account, given the risk of loss if the employee fails to contribute during the year the total amount is reimbursed.

Also, in order to limit potential financial exposure related to employees decreasing their flexible spending account elections, an employer should limit mid-year election changes that reduce flexible spending account contributions to amounts no less than amounts already reimbursed, as permitted under Notice 2020-29. Self-funded health plan sponsors will need to check with the stop-loss insurance carriers to determine if expanding the election changes for health coverage would increase stop-loss insurance premiums.

Employers will need to assess the financial impact and administrative complexities associated with these changes.

High Deductible Health Plans and IRS Notice 2020-15

In addition to the 125 Plan guidance, the Notice provides certain guidance related to benefits under high deductible health plans (HDHP). Under Notice 2020-15, a health plan that otherwise satisfies the requirements to be an HDHP will not fail to be one merely because it provides medical care services and items purchased for testing 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 regarding HDHPs and expenses related to testing for and treatment of COVID-19 applies to reimbursements of expenses incurred on or after Jan. 1, 2020. Additionally, the Notice explains that, for this purpose, the panel of diagnostic testing considered COVID-19 testing and treatment includes:

- Influenza A and B
- Norovirus and other coronaviruses
- Respiratory syncytial virus (RSV)
- Any items or services required to be covered with zero cost sharing under the Families First Coronavirus Response Act, as amended by the Coronavirus Aid, Relief and Economic Security (CARES) Act

High Deductible Health Plans and CARES Act

The CARES Act provides a temporary safe harbor for HDHPs providing coverage for telehealth and other remote care services. Under the CARES Act, eligible HDHPs may cover telehealth and other remote care services without a deductible or with a deductible below the minimum annual deductible otherwise required for eligible HDHPs.

Telehealth and other remote care services 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 a health savings account. 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 a health savings account.

Under the CARES Act, these changes are effective March 27, 2020, and apply to plan years beginning on or before Dec. 31, 2021. However, the Notice provides that telehealth and other remote care services under the CARES Act applies to services provided on or after Jan. 1, 2020, with respect to plan years beginning on or before Dec. 31, 2021.

This means that an employee covered under a HDHP who also received coverage beginning Feb. 15, 2020 for telehealth and other remote care services under an arrangement that was not an HDHP, and before satisfying the deductible for the HDHP, would not be disqualified from contributing to the health savings account during 2020.

Employer Action Steps

- Consider alternatives for adopting the optional changes to Section 125 Plans permitted under the Notice:

- Employee needs may differ, for example, based on whether employees experienced furloughs or reduced hours during the pandemic. Not all permitted changes may make sense for every employer based on employee circumstances.
- Balance the desire to limit the employer's financial exposure related to changes with the employees' needs.
- Plan sponsors of self-insured health plans will need to check with stop-loss insurance carriers as to any premium increase if the temporary flexible election options are adopted.
- Discuss alternatives for plan design changes with counsel.

- Work with plan service providers to implement the desired changes.
- Inform employees of all plan changes.
- Obtain all documentation related to employee election changes in Section 125 Plans.
- Work with counsel to timely adopt desired Section 125 Plan amendments and HDHP plan amendments related to COVID-19 testing and treatment, and telehealth and other remote care services.

To obtain more information regarding this alert, contact the Barnes & Thornburg attorney with whom you work or Nicole Bogard at 404-264-4016 nicole.bogard@btlaw.com, or Lori Shannon at 312-214-5664 or lori.shannon@btlaw.com.