



AMERICAN BENEFITS COUNCIL

May 12, 2020

SUMMARY OF IRS NOTICES 2020-29 AND 2020-33: GUIDANCE ON CAFETERIA PLANS, HEALTH FSAs AND DEPENDENT CARE FSAs

On May 12, the U.S. Treasury Department and the Internal Revenue Service (IRS) issued two notices that provide additional flexibility for employers with respect to cafeteria plans, health flexible spending arrangements (health FSAs) and dependent care flexible spending arrangements (dependent care FSAs):

- [Notice 2020-29](#) provides increased flexibility for cafeteria plans (and relatedly, health plans, health FSAs and dependent care FSAs) and also clarifies some COVID-19 related provisions related to health savings account (HSA)- eligible high deductible health plans (HDHPs). The guidance in this notice is specific to the COVID-19 crisis and is provided “to assist with the nation’s response to” COVID-19.
- [Notice 2020-33](#), released simultaneously, modifies the permissive carryover rule for health FSAs and includes a clarification regarding reimbursements of premiums by individual coverage health reimbursement arrangements (individual coverage HRAs). The guidance in this notice is *not* specific to the COVID-19 crisis.

Much of the additional flexibility provided in these notices responds favorably to requests the Council has made to Treasury the IRS over the course of the COVID-19 crisis, as set forth in our [April 13 letter](#), and as summarized in the [April 13 Benefits Byte](#). However, the relief is provided for 2020, rather than through 2021 as we generally requested, and we continue to evaluate whether additional flexibility or relief is needed, including for 2021.

In a related development, Democrats in the U.S. House of Representatives have released a draft bill on May 12, 2020, the [Health and Economic Recovery Omnibus Emergency Solutions \(HEROES\) Act \(H.R. 6800\)](#), intended to further address the COVID-19 crisis. As proposed, H.R. 6800 would provide some flexibility to cafeteria plans and FSAs as well, including permitting carryovers of unused amounts from 2020

to 2021, allowing one-time election changes before the end of 2020, and extending grace periods for the 2020 plan year to 12 months after the end of the plan year. The Council is continuing to review the HEROES Act, including these provisions.

NOTICE 2020-29: COVID-19 RELATED GUIDANCE

Cafeteria Plan Mid-Year Election Changes

Under the current cafeteria plan rules, which apply to salary reduction elections for employer-sponsored health coverage, health FSAs and dependent care FSAs, participants' elections generally are irrevocable and must be made prior to the first day of the plan year, except in certain circumstances as set out in the current cafeteria plans regulations (e.g., employee change in status).

In Notice 2020-29, Treasury and the IRS explain that "due to the nature of the public health emergency posed by COVID-19 and unanticipated changes in the need for medical care," some employers have expressed an interest in offering employees who initially declined coverage an opportunity to elect coverage, allowing employees to enroll in a different coverage option offered by the employer, or allowing employees to drop their employer coverage to enroll in other health coverage, such as a spouse's coverage. Treasury and the IRS also explain that some employees may have an increase or decrease in the need for or ability to access medical care or dependent care assistance due to the unanticipated closure of schools and child care providers and changes to the employee's work location or schedule. The notice observes that, depending on an employee's circumstances, the current rules allowing mid-year election changes may not apply to certain requests related to the COVID-19 public health emergency.

In response to these issues, which the Council described at length in our April 13 letter, Notice 2020-29 provides temporary flexibility for cafeteria plans to permit employees to make certain prospective mid-year election changes during calendar year 2020, regardless of whether the basis for the election change satisfies the criteria set forth in the current regulations. 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 during calendar year 2020 as follows:

- With respect to employer-sponsored health coverage, an employer may allow an employee to do any of the following:
 - Make a new election, if the employee initially declined to elect employer-sponsored health coverage.
 - Revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer (including changing from self-only to family coverage).

- Revoke an existing election, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other “comprehensive” health coverage not sponsored by the employer. The notice explains the employer must receive a written attestation from the employee and may rely on the attestation unless the employer has actual knowledge the employee is not, or will not be, enrolled in other comprehensive coverage. The notice provides optional model language that can be used for the attestation.
- With respect to a health FSA, an employer may allow an employee to revoke an election, make a new election, or decrease or increase an existing election.
- With respect to a dependent care FSA, an employer may allow an employee to revoke an election, make a new election, or decrease or increase an existing election.

Whether to allow these changes is at the discretion of the employer. If an employer decides to amend its cafeteria plan(s) to provide this flexibility, the notice provides that the employer may limit the period during which the election changes may be made, and is not required to provide unlimited election changes. But, the employer may, in its discretion, determine the extent to which such election changes are permitted and applied, provided any permitted election changes are applied on a prospective basis only and the changes do not result in failure to comply with the nondiscrimination rules applicable to cafeteria plans.

Treasury and the IRS also note that in determining the extent to which election changes are permitted and applied, an employer may wish to consider the potential for adverse selection and that, for health FSAs and dependent care FSAs, employers are permitted to limit mid-year elections to amounts not less than already reimbursed. The notice also includes a reminder that changes to the plan may implicate other laws, such as notice requirements under ERISA.

Further, 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 the issuance of the notice, permitted mid-year election changes otherwise consistent with the requirements for relief provided in the notice.

The Council had generally requested that Treasury and the IRS provide this additional flexibility for employers, although for health FSAs and dependent care FSAs, we had also requested that the flexibility be provided through plan years beginning in 2021, to account for ongoing uncertainty. We will continue to monitor the COVID-19 crisis and will consider whether to request additional election flexibility, including for 2021.

Health FSA and Dependent Care FSA Unused Amounts

Under existing rules, an employee's unused balance remaining in a health FSA or dependent care FSA at the end of the plan year generally must be forfeited unless, for a health FSA, the employer allows a carryover (generally limited to \$500, but see Notice 2020-33 summarized below), or, for a health FSA or dependent care FSA, the employer allows a grace period (under which a participant may apply unused amounts to pay expenses incurred during a period of up to 2 months and 15 days into the next plan year). Under current rules, an employer can't allow a health FSA to provide both a carryover and a grace period.

In Notice 2020-29, Treasury and the IRS explain that due to the COVID-19 emergency, "in particular unanticipated changes in the availability of certain medical care and dependent care," employees are more likely to have unused amounts or larger unused amounts as of the end of plan years or grace periods ending in 2020. In response to these issues, which were explained at length in the Council's April 13 letter, the notice provides an extended period to apply unused amounts remaining in a health FSA or dependent care FSA. Specifically, Notice 2020-29 provides that 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 dependent care FSA as of the end of a grace period ending in 2020 or plan year ending in 2020 to pay or reimburse expenses incurred through December 31, 2020.

This extension of time for incurring claims is available both to a cafeteria plan that has a grace period and a plan that provides for carryover (notwithstanding the general rule that a health FSA may not have both a carryover and a grace period). Although not explicitly stated in the notice, it also appears to apply to a health FSA or dependent care FSA that doesn't provide either a carryover or a grace period.

Further, the notice provides that 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 per the notice, will not be eligible to contribute to an HSA during that extended period, except in the case of an HSA-compatible health FSA.

The extended grace period provision applies on or after January 1, 2020 and on or before December 31, 2020 (e.g., to a grace period that expired on March 15, 2020). Also, the notice includes some examples to illustrate the relief, in particular to show how it applies to a health FSA that allows carryover.

This additional flexibility is somewhat responsive to the Council's requests. However, we had also requested that relief with respect to unused amounts be provided through plan years beginning in 2021 and that the Treasury Department and the IRS allow full balances to carry over for health FSAs (also see discussion below of Notice 2020-33). We had also requested that employers be permitted to allow

employees who are terminated from employment during the public health emergency to cash-out their health FSA or dependent care balance. We will continue to monitor the extent to which employees are unable to undergo elective procedures or use dependent care contributions due to the COVID-19 crisis, and will evaluate whether to request additional relief, including relief that applies in 2021.

Plan Amendments

The notice provides that an employer must adopt a plan amendment if it wishes to provide either the mid-year election cafeteria plan change flexibility or the extended period for unused amounts for a health FSA or dependent care FSA, each as described above. However, the amendment for the 2020 plan year need not be adopted until December 31, 2021, and may be effective retroactively to January 1, 2020, provided the cafeteria plan operates in accordance with the notice and the employer informs all employees eligible to participate in the cafeteria plan of the changes to the plan.

HDHPs

Notice 2020-29 also clarifies a few COVID-19 related issues for HSA-eligible HDHPs. The notice provides that:

- [Notice 2020-15](#), which provided that, until further guidance, HDHPs may cover COVID-19 testing and treatment prior to the satisfaction of the annual minimum deductible (as described in the [March 11 Benefits Byte](#)), applies with respect to reimbursements of expenses incurred on or after January 1, 2020.
- Testing and treatment of COVID-19, for purposes of Notice 2020-15, includes “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 the Families First Act, as amended by the CARES Act. (See the [Benefits Blueprint](#) summarizing the Families First Act and the CARES Act for more background on those laws).
- The 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. Section 3701 of the CARES Act, which was effective March 27, 2020, allows individuals to retain eligibility to contribute to an HSA if they also receive coverage for telehealth and remote care services outside an HDHP, and allows for HDHPs to retain HDHP status, even if coverage of telehealth and remote care services is provided before the minimum deductible is met. See the [Benefits Blueprint](#) on the CARES Act for more information.

NOTICE 2020-33: ONGOING GUIDANCE

Health FSA Carryovers

As noted above, under current guidance, an employer may elect to allow a health FSA to provide for a \$500 carryover. In June 2019, the president issued [Executive Order 13877](#), “Improving Price and Quality Transparency in American Healthcare to Put Patients First,” which included an order that the Secretary of the Treasury, to the extent consistent with law, issue guidance to increase the amount of funds that can carryover at the end of the year for FSAs.

Notice 2020-33, which Treasury and the IRS state is being issued in response to that executive order, increases the maximum \$500 carryover amount for a plan year to an amount equal to 20 percent of the maximum health FSA salary reduction contribution for that plan year. This amount is set under Internal Revenue Code Section 125(i) (at \$2,500), which is indexed for inflation (and as indexed, for 2020, is \$2,750).

Accordingly, 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% of \$2,750).

The notice provides that for an employer that wishes to allow this increased carryover amount, the plan must be amended. In general, this amendment 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 the plan year, provided the plan operates in accordance with the guidance under the notice and informs all employees eligible to participate in the plan of the carryover provision. However, for 2020, the amendment must be adopted by December 31, 2021.

Unlike Notice 2020-29, this guidance is not time limited or related to COVID-19 and will apply indefinitely. That said, although the additional carryover amount is not significant, the ability to carryover additional amounts could be helpful as participants face the potential for forfeitures due to the COVID-19 crisis, as noted above. However, the Council had requested, through plan years beginning in 2021, that employers be permitted to allow carryover of the full unused amounts, and that flexibility was not provided in this recent guidance.

Individual Coverage HRAs

In Notice 2020-33, the Treasury Department and the IRS also provide a clarification intended “to assist with the implementation of individual coverage health reimbursement arrangements (individual coverage HRAs)”, which are HRAs under which employers may provide contributions for employees to use to purchase coverage in the individual health insurance market or Medicare. (See the June 2019 [Benefits Blueprint](#) on individual coverage HRAs for more background).

The notice explains the general rule that only payment or reimbursement for medical care expenses incurred by an employee during a plan year is excludable from wages and income, and that medical care expenses are generally treated as incurred when a covered individual is provided medical care that gives rise to the expense, not when the amount is billed or paid. However, Treasury and the IRS acknowledge that this raises administrative issues for an individual coverage HRA, to the extent that a participant must pay, prior to the first day of a plan year, all or part of the premium for individual health insurance coverage or Medicare during that plan year.

Accordingly, Notice 2020-33 provides that a plan may treat an expense for a premium for health insurance coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid. Thus, an individual coverage HRA with a calendar year plan year may immediately 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.