

IRS allows mid-year election changes for health plans and FSAs; FSA extended grace period also available



This year, many employees are finding out that their health and dependent care needs are different from what they anticipated for 2020 due to the COVID-19 public health emergency and its related economic impact. Under normal circumstances, employers are limited by IRS rules, which generally prohibit mid-year changes to cafeteria plan elections for employer-sponsored health coverage and flexible spending account contributions, except in certain limited circumstances such as marriage or the birth or adoption of a child. In light of the unexpected changes from COVID-19, the IRS released [Notice 2020-29](#) to provide employers flexibility to allow additional mid-year cafeteria plan health coverage and FSA election changes, as well as other relief. In addition, Congress is considering further changes related to election changes. This article provides a high-level summary of these new options in the IRS notice for employers.



New flexibility for cafeteria plans and FSAs

Notice 2020-29 is intended to provide employers with additional flexibility with respect to cafeteria plan health coverage elections and the use of FSA funds. Employers may choose whether to adopt any, some or none of the new options.

Permitted changes to cafeteria plan elections for health coverage and FSA contributions

The notice allows certain cafeteria plan salary reduction election changes related to health coverage and FSAs, *for mid-year elections made in calendar year 2020 only.*

For **health plan enrollment**, an employer may allow employees to make the following changes in calendar year 2020. These changes are allowed even if the employee hasn't experienced a qualifying event that would normally allow a change in election. *These changes may be made on a prospective basis only.*

- Newly enroll the employee or family member in employer sponsored health coverage.
 - This is for individuals who previously did not elect coverage.
 - The notice doesn't define or limit the definition of employer sponsored health coverage for this purpose. Due to this, the term should reasonably include health excepted benefits, such as dental and vision, hospital indemnity and other fixed indemnity coverage and specified disease coverage, if this type of coverage is offered by an employer as part of an ERISA plan. With this in mind, an employee could add such coverage now, even if the employee didn't previously elect the coverage.

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- Change to another health plan option of the same employer.
 - For example, an employee who previously elected self-only coverage could switch to family coverage, or vice versa.
- Prospectively revoke health coverage, but only if the employee provides an attestation that the employee is or will be enrolled in comprehensive health coverage not sponsored by the employer.
 - The IRS has provided a sample attestation form that may be used for this purpose.

With respect to **health FSAs and dependent care assistance programs (DCAPs)**, in calendar year 2020, an employer may allow employees to prospectively enroll, increase, decrease or revoke their elections for any reason.

- By plan design, employers may limit any mid-year changes to health FSA or DCAP elections to the reimbursement that was already provided under the arrangement. For example, if an employee had originally elected \$2,500 for their health FSA and had already received \$2,000 in reimbursements, the employer could limit the decrease/revocation to \$2,000 to ensure that salary reductions will cover the reimbursements.
- Although salary reductions must be prospective, any increase in a health FSA or DCAP election may be used for amounts incurred in the plan year prior to the election change.
- Changes may not be retroactive. Individuals newly electing FSA coverage cannot be reimbursed for prior expenses and no refunds of amounts already salary reduced may be provided.





Extension of grace period for health FSAs and DCAPs for plan year or grace period ending in calendar year 2020

Normally, health FSAs and DCAPs may have a grace period for expenses of up to 2 ½ months after the end of the plan year. Any unused amounts remaining at the end of the plan year may be used to pay expenses incurred for the same benefits during the grace period. Whether to have a grace period and the length of any grace period (subject to the 2 ½ month limit) are matters of plan design. Alternatively, a health FSA may allow a limited amount of unused benefits to carry over into the next plan year. A health FSA cannot have both a grace period and allow a carryover.

Under the new guidance, a health FSA or DCAP with a grace period or plan year ending in 2020 may permit reimbursement of expenses incurred through Dec. 31, 2020.

- As under the normally applicable rules, health FSA amounts may only be used to reimburse medical expenses and DCAP amounts may only be used to reimburse dependent care expenses.
- For health FSAs with a plan year ending in 2020, the extended payout period through Dec. 31, 2020, is allowed, even if the plan also has a carryover. Thus, the new IRS guidance effectively allows a combination of a grace period and carryover for health FSAs. The IRS notice includes examples of how the new extended grace period works with plans that have a carryover for the plan year starting in 2019.
- Note that the health FSA carryover amount is increased to \$550 for plan years beginning on or after Jan. 1, 2020. The carryover for the 2019 plan year that is used in 2020 is still \$500.
- As with the other options, the employer has flexibility. For example, an employer may choose not to adopt this extended grace period or may end the period before Dec. 31, 2020.
- A calendar year plan without a grace period cannot take advantage of the new relief for the 2019 plan year.

There are special issues to consider for employers that have **high deductible health plans (HDHPs)**:

- An employer that adopts the extended grace period for a general health FSA will make an employee ineligible for an HSA through the end of the month in which the grace period ends, which is Dec. 31, 2020, if the full extension is provided under the plan.
- Employers with HDHPs may want to consider ending any grace period no later than Nov. 30, 2020, to allow HSA eligibility and a full contribution through the December full contribution rule.
- Under the **December full contribution rule**, individuals who are eligible for an HSA on Dec. 1, 2020, may make the maximum HSA contribution for all of 2020. To get this full contribution benefit and avoid adverse tax consequences, the individual must remain eligible for an HSA through Dec. 31, 2021. If the individual is not HSA eligible for this full period, then the 2020 contribution will be pro-rated based on the period of HSA eligibility in 2020, and the excess is taxable income. An additional 10% tax also applies to the excess contributions.

Plan amendments required by Dec. 31, 2021

An employer that adopts any of the new options, or that increases the health FSA carryover limit to \$550 for plan years starting in 2020, must adopt a plan amendment by Dec. 31, 2021.



Conclusion

The relief options provided with respect to cafeteria plans and FSAs for 2020 may be useful tools for employers who are helping their employees deal with changing circumstances due to COVID-19. What will work best may vary based on the circumstances and each employer should consult with their own advisers. Congress is also considering additional changes, including allowing increased carryovers for health FSAs and DCAPs from 2020 to 2021 and allowing more extended grace periods. An update will be provided on any further developments.

The information above is provided for general informational purposes and is not provided as tax or legal advice for any person or for any specific situation. Employers and employees and other individuals should consult their own tax or legal advisers about their situation.

Aflac | Aflac New York | WWHQ | 1932 Wynnton Road | Columbus, GA 31999

