

# THE ECFC FLEX REPORTER

The ECFC FLEX Reporter provides in-depth coverage of developments affecting the administration of cafeteria plans, flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs).

Articles in The ECFC FLEX Reporter are authored by nationally recognized attorneys and consultants, and edited by John R. Hickman, a partner in the Employee Benefits Practice Group of Alston & Bird, LLP.

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*Important Note: The information contained herein is not intended to be legal, accounting or other professional advice. We assume no liability whatsoever in connection with your use or reliance upon this information. This information does not address specific situations. If you have questions about your specific situation, we recommend that you obtain independent professional advice.*

## Overview of IRS Notices 2020-29 and 2020-33 Covering Changes to Cafeteria Plans, Health Care FSAs, and Dependent Care FSAs

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### OVERVIEW

The following summary of changes to Cafeteria Plans, Health Care FSAs, and Dependent Care FSAs is provided as an overview for our readers of the potential impacts of recent government actions. This is not legal advice and the relief actions are complex. As always, we strongly encourage our readers to consult their legal or benefits counsel for conclusive guidance on how the actions apply in their circumstances.

On May 12, 2020, the Department of the Treasury (the Treasury) and the Internal Revenue Service (IRS) published two notices as part of ongoing relief efforts related to the Novel Coronavirus Disease (COVID-19). These notices offer guidance for employers to allow additional flexibility (including telehealth services) with respect to their section 125 cafeteria plans, Healthcare Flexible Spending Accounts (Health Care FSAs) and Dependent Care Assistance Programs (DCAPs) during the 2020 calendar year.

- IRS Notice 2020-29<sup>1</sup> provides greater flexibility for cafeteria plans, Health Care FSAs, and DCAPs with respect to mid-year election changes, an extension of claim periods for plan participants through 2020, and clarifies previously released guidance<sup>2</sup> with respect to Health Savings Account (HSA)-qualified High Deductible Health Plans (HDHPs).
- IRS Notice 2020-33<sup>3</sup> replaced the current \$500 carryover amount for Health Care FSAs with an amount equal to twenty percent (20%) of the annual salary reduction limit (indexed for inflation) and clarified the rules regarding reimbursements of health care premiums by Individual Coverage Health Reimbursement Arrangements (ICHRAs).
- While the guidance issued in Notice 2020-29 is directly related to and designed “to assist with the nation’s response” to COVID-19, the guidance in Notice 2020-33 is not COVID-19 specific.

### Notice 2020-29

#### Mid-Year Election Changes Under a Section 125 Cafeteria Plan

Generally, prior to the changes introduced by IRS Notice 2020-29, cafeteria plan elections were required to be irrevocable and made before the first day of the plan year. Plans may allow for mid-year election changes following certain “change in status” events (e.g., termination of employment).

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<sup>1</sup> <https://www.irs.gov/pub/irs-drop/n-20-29.pdf>

<sup>2</sup> <https://www.irs.gov/pub/irs-drop/n-20-15.pdf>

<sup>3</sup> <https://www.irs.gov/pub/irs-drop/n-20-23.pdf>

In Notice 2020-29, the IRS explains in the Introduction to the guidance that the purpose of the guidance is to assist with the response to the 2019 Novel Coronavirus outbreak (Covid-19) and unanticipated changes in the need for medical care. Given that the ability to receive non-emergency medical care or the need or the ability to secure child care when a parent either is not working or is working from home, the need for reimbursement may be reduced or even eliminated.

Under the guidance contained in Notice 2020-29, a cafeteria plan sponsor may – at its discretion – amend its cafeteria plans (health coverage, Health Care FSAs and DCAPs) to permit employees to make certain mid-year election changes prospectively during the 2020 calendar year:

- Make a new election to participate in employer-sponsored health coverage if the employee initially declined to elect employer-sponsored health coverage.
- Revoke an existing election for employer-sponsored health insurance coverage and make a new election to enroll in different health coverage provided by that employer (including changing enrollment to add otherwise-eligible dependents to the coverage prospectively).
- Revoke an existing election for employer-sponsored health coverage, provided that the employee attests in writing that the employee is enrolled – or immediately will enroll – in other “comprehensive” health coverage not provided by the employer (optional model attestation language is included in the notice).
- Revoke an election, make a new election, or increase or decrease an election to a Health Care FSA.
- Revoke an election, make a new election, or increase or decrease an election to a DCAP on a prospective basis.

Employers are not required to provide these election changes and can determine which changes they will permit. The relief provided in Notice 2020-29 may be applied retroactively to periods prior to this guidance and on or after January 1, 2020 to address a cafeteria plan that – prior to the issuance of this guidance - permitted mid-year election changes that are otherwise consistent with the requirements of the Notice.

Also, in determining the extent to which these election changes are permitted and applied, the Treasury and IRS note that an employer may wish to consider (but is not required to consider) the potential for adverse selection and limit mid-year elections to instances in which an employee’s coverage will be increased or improved as a result of the election (e.g., by switching from self-only to family coverage). For Health Care FSAs and DCAPs, employers are permitted to limit mid-year election changes to amounts no less than amounts already reimbursed.

#### Extended Claims Period for Health Care FSAs and DCAPs

Generally, any unused balances remaining in an employee’s Health Care FSA or DCAP at the end of the plan year are forfeited by the plan participant (the “use-it-or-lose-it” rule). Health Care FSAs or DCAPs may provide a grace period immediately following the end of each plan year during which unused amounts at the end of the plan year may be used to reimburse eligible medical expenses incurred during

the grace period (which cannot extend more than 2 months and 15 days [“2½ months”] beyond the end of the preceding plan year). Employers may amend their Health Care FSAs or DCAPs to permit employees to apply the unused amounts in their Health Care FSA or DCAP as of the end of a grace period ending in 2020 (e.g., March 15, 2020 for the 2019 calendar plan year) or plan year ending in 2020 to pay for reimbursable medical expenses incurred on or before December 31, 2020. The relief in Notice 2020-29 applies both to general purpose and limited-purpose Health Care FSAs.

The extension of time for incurring claims is available both to cafeteria plans that have a grace period and plans that provide for a carryover (notwithstanding the general rule<sup>4</sup> that Health Care FSAs may not have both a carryover and a grace period). In other words, a Health Care FSA that allows a carryover would also be permitted to amend the plan to extend the claims period to December 31, 2020. However, this additional flexibility would only benefit those plans ending on or after January 1, 2020 (i.e., a non-calendar plan year). For a Health Care FSA with a non-calendar plan year (e.g., February 1, 2019 – January 31, 2020), a participant would be able to use any remaining amounts from the 2019 plan year as of January 31, 2020 to pay for reimbursable expenses through December 31, 2020, even amounts exceeding the otherwise-applicable \$500 carryover limit for the 2019 plan year.

Conversely, a calendar-year Health Care FSA (e.g., January 1, 2019 - December 31, 2019) with a carryover would already allow participants to use up to \$500 through the end of December 31, 2020 irrespective of this guidance and would not gain any additional flexibility from the extended claims period nor would the 2019 carryover dollars be increased by the provisions of Notice 2020-33 (see below).

However, an individual who has unused amounts remaining at the end of the plan year or grace period ending in 2020, and who is allowed the extended claims period per Notice 2020-29, will be ineligible to make HSA contributions during the extended period (except in the case of an HSA-compatible Health Care FSA, e.g., a limited-purpose FSA). Thus, employers who have HDHPs and facilitate the opening and maintenance of employees’ HSAs should exercise care to make sure their adoption of this extension does not adversely impact their employees’ ability to contribute to their HSAs.

A similar claims period extension can be made available for DCAPs.

### Plan Amendments

Plan amendments that allow for these mid-year cafeteria plan election changes and the extension of the claims period must be adopted before December 31, 2021, and can be retroactive to January 1, 2020, provided that the plan is operated in accordance with Notice 2020-29. Plan sponsors must notify eligible employees of the changes made under these temporary rules.

Regardless, be cautious about deferring the preparation and the adoption of the actual Amendment to avoid forgetting to adopt the necessary Amendment(s). Memories can be short or responsible people may leave, or other unexpected distractions may occur; and as a result, required Amendments never get adopted.

### COVID-19 Testing and Treatment for HSA-Compatible HDHPs

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<sup>4</sup> <https://www.irs.gov/pub/irs-drop/n-13-71.pdf>

In the previously released Notice 2020-15, the guidance allows HDHPs to provide benefits associated with testing for and treatment of COVID-19 either without a deductible or with one that is below the otherwise required minimum annual deductible; therefore, an HDHP providing such care on a no- or low-cost basis will not fail to qualify as an HDHP. Consequently, employees' eligibility to make contributions to their HSAs will not be jeopardized, even if medical expenses related to COVID-19 testing or treatment are paid by the HDHP. Notice 2020-29 clarifies that this relief applies for expenses incurred on or after January 1, 2020 and clarifies what expenses are to be treated as COVID-19 testing and treatment, including "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 Coronavirus Aid, Relief, and Economic Security (CARES) Act.

### Telemedicine and HSA-Compatible HDHPs

Just as HSA-qualified health plans can provide benefits related to COVID-19 testing and treatment either without a deductible or with reduced or no-cost sharing without jeopardizing HSA eligibility, Section 3701 of the CARES Act expanded this to include all remote care service expenses (i.e., telemedicine). Previously, plans that covered telemedicine prior to reaching the deductible, disqualified HSA holders from making HSA contributions. This change, effective as of March 27, 2020 (the date of enactment) applies for plan years beginning on or before December 31, 2021. Notice 2020-29 provides that such services provided on or after January 1, 2020 will also be permitted in an HSA-compatible HDHP.

### Notice 2020-33

#### Health FSA Carryover

Under existing guidance, an employer may elect to allow a Health Care FSA to provide that unused amounts at the end of the plan year could be carried over to the following plan year, which was limited to \$500. In June 2019, President Trump issued Executive Order 13877 – "Improving Price and Quality Transparency in American Healthcare to Put Patients First,"<sup>5</sup> which directed the Secretary of the Treasury – to the extent consistent with the law - to issue guidance that would increase the amount that could be carried over at the end of the year for Health Care FSAs. Notice 2020-33, issued in response to the Executive Order, provides that the \$500 carryover amount is increased to an amount equal to twenty percent (20%) 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) and indexed for inflation (i.e., \$2,750 for 2020). Accordingly, the maximum carryover amount from a plan year beginning in 2020 to be carried over to the immediately subsequent plan year beginning in 2021 is \$550 (= \$2,750 \* 20%).

Notice 2020-33 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 Notice 2020-33

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<sup>5</sup> <https://www.govinfo.gov/content/pkg/FR-2019-06-27/pdf/2019-13945.pdf>

and informs all eligible employees of the carryover provision). For 2020, however, the change must be adopted by December 31, 2021 and can be retroactive to the 2020 plan year.

Unlike the provisions of Notice 2020-29, this guidance is not time-limited and will apply indefinitely.

### ICHRAs

An Individual Coverage Health Reimbursement Arrangement (ICHRA) is designed to provide a means for employees to be reimbursed for premiums for health insurance coverage incurred after the beginning of the ICHRA's plan year. Notice 2020-33,II,B, "Timing of reimbursements by health plans" provides clarification intended "to assist with the implementation of individual health reimbursement arrangements," which are HRAs under which employers may provide contributions to use to purchase coverage in the Health Insurance Marketplace or Medicare.

Notice 2020-33 provides that the ICHRA is permitted to treat health care premiums as incurred on (1) the first day of each month of coverage, (2) the first day of the period of coverage, or (3) the date the premium is paid. Therefore, payment of the premium for coverage made before the beginning of the plan year can be reimbursed if the insurance coverage starts during the plan year.

### Conclusion

The additional flexibility with respect to cafeteria plan benefits is a welcome response to the ongoing economic and health impacts of the COVID-19 pandemic. While the guidance described above provides relief for 2020, one should continue to monitor these developments and remain abreast of future relief efforts for the current year and possibly through 2021. As noted above, the government's actions are complex, and you are encouraged to carefully consider the issues raised in this Article for future developments.

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The information contained in this memo was largely adapted from a Compliance Alert issued by HealthEquity, Inc. and is not intended to be legal, accounting, or other professional advice. We assume no liability whatsoever in connection with its use, nor are these comments directed to specific situations.