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IRS Temporarily Flexes Rules for Flex Benefit/Section 125 Plans

By Andrew E. Graw

IRS Notice 2020-29 gives employers new opportunities to help employees who participate in Section 125 plans deal with COVID-19.

Under Notice 2020-29, employers can allow participants and eligible employees of their Section 125 plans (also referred to as cafeteria plans and flexible benefit plans) to:

- Change their employer-sponsored health plan coverage for 2020 by (i) opting for coverage if the coverage had been declined; (ii) electing different coverage, if any, offered by the employer than the coverage previously elected for the year; or (iii) terminating coverage entirely. An employee who wishes to terminate coverage is required to attest in writing that he or she has enrolled or immediately will enroll in other health coverage. Notice 2020-33 includes a form of attestation an employer may use.
- Change their health care and/or dependent care flexible spending account (FSA) elections for 2020 by revoking an election, making a new election, or increasing or decreasing an existing election.
- Apply unused amounts in a health or dependent care FSA as of the end of a grace period or plan year ending in 2020 to pay for or reimburse medical care or dependent care expenses, respectively, incurred through December 31, 2020. This will apply regardless of whether the employer's Section 125 plan allows participants a grace period to apply unused amounts from the prior year or allows participants to carry over up to $500 of unused amounts from the previous year (in Notice 2020-33, the IRS also announced that the carryover amount for health FSAs would be indexed for inflation, thereby allowing up to $550 of unused health FSA amounts for 2020 to be carried over to the 2021 plan year). For example, if a participant had $600 remaining in his health FSA at the end of 2019, he can apply the full $600 toward claims incurred during 2020 regardless of whether the Section 125 plan uses the "grace period" or "carryover" rule.

Employers can offer any or all of these changes and may limit the ability of employees to make election changes during a special election period. Election changes cannot be retroactive; they may only be made prospectively. The changes in election may be made without requiring that the employee experience a qualifying "change in status" event (such as marriage, divorce, birth or adoption of a child, and certain other life events), as would normally be required. Any election change opportunities must comply with nondiscrimination requirements applicable to Section 125 plans.

The relief should come as welcome news to many employees. In particular, with parents homebound, many day care centers closed due to COVID-19, and the opening of summer camps uncertain, employees who elected to contribute to dependent care FSAs may not be able to use those accounts to the extent they had planned. Others may simply prefer to receive the cash that would otherwise have gone into a dependent care FSA through the remainder of 2020. This relief, if implemented by an employer, affords all employees the ability to reduce or discontinue contributions to their dependent care FSAs. Likewise, employees who anticipate incurring more health care expenses than they expected at the start of 2020 may wish to increase their health care FSA contributions.

Employers should take care in allowing employees to revoke health care FSA elections. Since employees are required to receive reimbursement for their entire year's health care FSA election regardless of whether they contribute the amounts to their FSA accounts, it is possible for an employee to receive reimbursement for more than he or she contributes. Allowing such an employee

to fully revoke the contribution election would likely prevent the employer from recapturing the excess reimbursement amounts.

The election changes permitted by Notice 2020-29 apply to both fully insured health plans and self-insured health plans. An employer that desires to allow employees to make midyear health coverage changes (absent a change in status event) under an insured health plan should consult with the insurance carrier to make certain that the insurer will permit such changes. An employer with a self-insured health plan should consider whether allowing employees to choose coverage that had previously been declined will increase health benefit costs. A self-insured employer should also check with its stop-loss carrier to make sure the stop-loss policy will cover claims by employees who make midyear coverage changes without a qualifying change in status event.

Employers are required to amend their Section 125 plans to conform to any implemented changes by no later than December 31, 2021. The amendments can be retroactive to January 1, 2020, so long as the plan is operated in accordance with the terms implemented and the employer informs all eligible employees of the changes.

While the flexibility shown by the new IRS guidance is welcome, employers should carefully consider which, if any, of the new tools they wish to extend to employees. Once that initial decision is made, employers will then need to communicate any changes to employees and follow up by amending their Section 125 plans.

Lowenstein Sandler's Employee Benefits & Executive Compensation Practice Group is available to help guide you through the choices made available by Notice 2020-29 and the broad spectrum of governmental relief issued to address the COVID-19 pandemic.

To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking here.

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