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EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

IRS Provides Additional COVID-19 Related Relief for Section 125 Plans

Overview

On May 12, 2020, the Internal Revenue Service ("IRS") released Notice 2020-29 (the "Notice") and Notice 2020-33, which permit employers to amend their Internal Revenue Code Section 125 cafeteria plans ("Section 125 plans") to provide increased flexibility with respect to mid-year election changes, as well as to extend the period in which participants may incur expenses to spend down unused amounts in health care and dependent care flexible spending accounts ("FSAs"). In addition, employers whose health care FSA includes the $500 "carryover" feature (described below) may amend their plan to provide that the $500 limit is to be indexed for inflation. The guidance also clarifies how individual coverage health reimbursement arrangements may reimburse participants for premium expenses that the participant is required to pay before the beginning of a plan year. This guidance provides welcome relief to employers who have sought to provide flexibility to employees seeking to make Section 125 plan election changes to reflect changes in circumstances caused by the coronavirus pandemic.

Election Change Flexibility

Notice 2020-29 permits employers to amend their Section 125 plans to provide temporary additional flexibility to employees to make certain mid-year election changes that otherwise might not have been permissible under existing Section 125 election change rules. Section 125 plans permit participants to choose among benefits consisting of cash and qualified benefits—for example, permitting participants to pay on a pre-tax basis for their share of the cost of health coverage offered by the employer, or to contribute a pre-tax basis to an FSA.

A fundamental requirement under Section 125 is that the participant make his or her benefit election prior to the first day of a plan year and that the election is irrevocable during the plan year. An employer is permitted to design its Section 125 plan to allow mid-year election changes in the circumstances described in IRS Section 125 regulations. Those election change events include certain "changes in status" experienced by the participant (such as marriage, number of dependents), as well as other events such as significant changes in the cost of coverage, losses of coverage, etc.

As employees began to experience the effect of the pandemic in the form of layoffs, furloughs, reductions in pay, remote work, and loss of child care, employers have struggled to determine whether the existing Section 125 election change rules would permit mid-year election changes being requested by affected employees. Notice 2020-29 permits (but does not require) employers to amend their Section 125 plan to allow employees to make the following election changes <u>during calendar year 2020:</u>

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- Make a new election for employer-sponsored health coverage on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage;
- Revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis (this includes changing enrollment from self-only coverage to family coverage);
- Revoke an existing election for employer-sponsored health coverage on a prospective basis, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer;
- Revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA; and
- Revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care FSA.

If an employer amends its Section 125 plan as described in the third bullet above, to permit a participant to revoke an existing election of employer-sponsored health coverage on the basis that the employee is enrolled in other health coverage not sponsored by the employer, the employer must implement a process to obtain a written attestation from the employee that the employee is enrolled in or will immediately enroll in, other health coverage not sponsored by the employer. The Notice provides that the employer may rely on the employee's attestation unless the employer has actual knowledge that the employee is not, or will not be, enrolled in other comprehensive health coverage not sponsored by the employer. The Notice includes model attestation language that will be considered acceptable by the IRS. The Notice doesn't specify the method by which the written attestation may be submitted by the employee. Employers that use third party enrollment vendors should discuss the attestation process with their vendors before deciding to implement this particular election change rule.

There are several additional important points about the election change provisions:

- As noted, the new events are optional, not required, and an employer may choose to add none or only some of the events. For example, an employer could decide to not allow employees to drop coverage (and thus avoid the attestation requirement). Or, an employer may limit the extent to which an election change is permitted and applied (provided that such limitations are not discriminatory). So, for example, an employer that adds the FSA election change rules is permitted to limit mid-year elections to amounts not less than the amount already reimbursed to the participant;
- The IRS pointed out a practical consideration for employers considering the health insurance election change events—to prevent adverse selection of health coverage, an employer may want to limit those election changes to circumstances where the employee's coverage will be increased or improved (e.g., employee moving from self-only coverage to family coverage, or from a low option plan to a high option plan);
- The rules apply to election changes with respect to both self-insured and insured health plans. Employers whose group health plans are insured should confirm that their insurance carrier will permit the employer to implement the new election change rules with regard to health insurance. Employers with self-insured plans that have stop loss coverage may want to confirm that the stop loss

carrier would not deny claims as a result of an employer allowing employees to newly enroll, change options, or add family members;

- Though not clear, it appears that the guidance only allows changes to major medical coverage and FSAs, and not other qualified benefits, such as dental and vision;
- While the election changes made by employees under the new rules must apply prospectively, the guidance itself may be applied retroactively to January 1, 2020, so employers that may have permitted election changes prior to the issuance of the Notice are provided relief if the election changes permitted were consistent with the requirements of the Notice; and
- Plan amendments are required, but may be adopted as late as December 31, 2021, provided that the Section 125 plan operates in accordance with the Notice and the employer notifies all employees who are eligible to participate in the Section 125 plan of the changes to the plan.

Extended Claims Period for FSAs

A basic rule under Section 125 is that a Section 125 plan cannot operate to permit a participant to defer compensation from one year into a subsequent year. For FSAs, this requirement is generally expressed as the "use-it-or-lose-it" rule. An FSA participant who does not incur sufficient eligible expenses during a plan year to exhaust his or her FSA account balance forfeits the unused balance. Most employers provide a claim submission "run-out" period so that a participant who incurs an eligible expense near the end of a plan year has a reasonable period of time after the end of the plan year to submit the claim for reimbursement. In addition, in accordance with IRS guidance published in 2005, many employers design their FSA plans to permit a "grace period" following the close of the plan year in which participants may incur eligible expenses that may be reimbursed from unused year-end FSA balances (the "Grace Period"). The maximum permitted Grace Period is two months and 15 days following the end of the plan year (e.g., March 15th for a calendar year plan). In 2013, the IRS issued guidance that permitted employers to include a "carryover" rule in their health FSAs, which permits a participant to carry over to the following plan year up to $500 in unused health FSA amounts (the "Carryover"). An employer can't have both the Grace Period and Carryover for health FSAs in its Section 125 plan. (The Carryover feature is not permitted for dependent care FSAs, but dependent care FSAs are permitted to have a Grace Period.)

Notice 2020-29 permits an employer to amend its Section 125 plan to provide an extended period for participants to incur eligible expenses that can be reimbursed under a health or dependent care FSA. The amendment would permit a participant who had unused amounts in a health FSA or dependent care FSA as of the end of a Grace Period or plan year ending in 2020 to use that balance to reimburse expenses incurred through December 31, 2020. For example, an employer with a calendar year Section 125 plan that normally uses the maximum Grace Period for its health FSA (allowing a participant who had a balance left in his or her account on December 31, 2019 to be reimbursed from that balance for expenses incurred through March 15, 2020) could amend its plan to provide for the extended period allowed by the Notice, and a participant with a balance in his or her health FSA as of March 15, 2020 could continue to be reimbursed from that balance for eligible expenses incurred by the employee through December 31, 2020.

There are several additional important points about the extended claims period:

- The extension is optional. An employer is not required to implement it at all, or may choose to implement for only one of its FSAs (e.g., health FSA but not dependent care);
- It is permissible for this extension of time for incurring claims to be implemented for plans that currently have a Grace Period, and for health FSAs that currently have a Carryover, even though the normal rule is that a health FSA can't have both the Carryover and Grace Period;
- As a practical matter, this amendment option will not be helpful for the following calendar year FSAs:
  - Health FSA with a Carryover Feature
  - Health FSA with neither a Carryover Feature nor a Grace Period
  - Dependent Care FSA without a Grace Period
- If implemented by an employer, this extended period to incur claims will mean that a participant will be considered to be covered by a health plan that is not a qualifying high deductible health plan for the entire extension period (i.e., through December 31, 2020) and thus will not be eligible to contribute to a health savings account during that period, unless the health FSA is an "HSA-compatible" health FSA (only reimbursing dental and vision expenses or only reimbursing expenses after the deductible had been satisfied under the high deductible health plan); and
- A plan amendment is required to implement the extension period, but may be adopted as late as December 31, 2021, provided that the Section 125 plan operates in accordance with the Notice and the employer notifies all employees who are eligible to participate in the Section 125 plan of the changes to the plan.

Clarification of Prior IRS Guidance on HDHPs

In March of this year, the IRS issued Notice 2020-15 to provide relief to employers whose HDHPs covered medical care services and items related to testing and treatment for COVID-19 prior to the participant's satisfaction of the deductible (see our LEGALcurrents here). Notice 2020-29 clarifies that the relief provided in Notice 2020-15 applies with respect to plan coverage of expenses incurred on or after January 1, 2020, and that the relief applies to an HDHP's coverage of the diagnostic testing required by the Families First Coronavirus Response Act, as amended by the CARES Act (see our LEGALcurrents here).

Effective Date for CARES Act HDHP Safe Harbor for Telehealth

The CARES Act permits HDHPs to cover all (not just COVID-19 related) telehealth services before a participant has satisfied the plan deductible, without causing the plan to lose its status as a health savings account compatible HDHP. The CARES Act did not specify an express effective date for the provision, stating only that it applied for plan years beginning on or before December 31, 2021. Notice 2020-29 specifies that the CARES Act provision applies with respect to services provided on or after January 1, 2020.

Indexing of Health FSA Carryover Amount

As noted above, pursuant to IRS guidance issued in 2013, health FSAs have been permitted to include a Carryover feature under which up to $500 of unused health FSA funds at the end of a plan year may be carried over and used by the participant in the following plan year. The $500 maximum figure (an employer may design its health FSA to permit carryover of a lesser amount) has not been subject to indexing for cost-

of-living adjustments (unlike the $2,500 maximum health FSA contribution amount, which has been increased for cost-of-living adjustments and is $2,750 for 2020). Notice 2020-33 provides that the maximum Carryover amount will be equal to 20% of the maximum contribution amount for the applicable plan year. For the 2020 plan year, this results in a maximum Carryover amount of $550 (20% of $2,750). If an employer wants to implement the indexed Carryover amount for the 2020 plan year (which would result in a maximum amount of $550 carried over into the 2021 plan year), the employer's Section 125 plan must be amended on or before December 31, 2021.

Clarification of Reimbursement of Individual Health Policy Premium Expenses

In 2019, the Treasury, Department of Labor, and Department of Health and Human Services issued regulations that permit employer-sponsored health reimbursement arrangements ("HRAs") to reimburse premium expenses paid by individuals for individual health coverage or Medicare. Plans that comply with the guidance ("Individual Coverage HRAs" or "ICHRAs") would be considered to satisfy the Affordable Care Act's "integration" requirement that otherwise would prohibit the employer from offering HRA reimbursements for individual coverage purchased by an employee. A general requirement for an ICHRA is that it may not reimburse expenses incurred before the beginning of a plan year. In Notice 2020-33, the IRS notes that this rule may present a hardship for ICHRA participants who are required to pay premiums for their individual coverage prior to the beginning of the ICHRA plan year (e.g., a participant in an ICHRA with a calendar-year plan year may be required by an insurance carrier to pay his or her January individual coverage premium before January 1st in order for the coverage to be effective January 1st). Notice 2020-33 provides that an ICHRA is permitted to 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. Pursuant to (3), an ICHRA would be permitted to immediately reimburse a substantiated premium for health insurance coverage that begins on January 1 of a plan year, even if the individual paid the premium for that coverage prior to the first day of the plan year.

If you have any questions regarding the amendments to Section 125, please contact any member of the Employee Benefits and Executive Compensation group at 585.232.6500, 716.853.1616, or visit www.hselaw.com.

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