IRS Issues Cafeteria Plan Relief, Providing Employers Significant Discretion

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The Internal Revenue Service ("IRS") recently issued guidance relaxing several cafeteria plan rules to help employees deal with unanticipated COVID-19 expenses. Employers that sponsor cafeteria plans will need to decide whether to amend their plans to adopt these optional rule changes. We have summarized the rule changes below, including some important employer considerations.

Note that the IRS also issued recent guidance clarifying the retroactive application of CARES Act relief for high deductible health plans and extending the period in which premium expenses may be reimbursed. These changes will be addressed in a separate post.

Extended 2020 Election Period

The cafeteria plan rules provide that an annual election to enroll or not to enroll in an employer sponsored health coverage option is generally irrevocable and must be made prior to the first day of the plan year. Effective only for the 2020 calendar year, the IRS has given employers the discretion to allow the following mid-year election changes on a prospective basis without regard to whether the normally applicable conditions for mid-year election changes are satisfied:

- Employees who initially declined employer-sponsored health coverage may elect to enroll.
- Employees who enrolled in an employer-sponsored health coverage option may change this election and enroll in another employer-sponsored health coverage option (e.g., switch from self-only coverage to family coverage, or vice versa).
- Employees who enrolled in an employer-sponsored health coverage option may revoke their election, provided they attest in writing that they are enrolled or will enroll in other health coverage not sponsored by the employer.
- Employees may revoke an election to enroll in a health care and/or dependent care flexible spending arrangement ("FSA"), or decrease or increase an existing FSA election.

Employers have the further discretion to determine how frequently to permit these mid-year election changes and under what circumstances. For example, an employer may prohibit an employee from decreasing payroll contributions to an FSA below the amount the employee has already been reimbursed before making the new election.

In deciding whether to adopt these mid-year change options, employers will want to consider the impact adverse selection may have on claims experience, the potential for impermissibly discriminating in favor of highly compensated employees, and the administrative burdens of implementation.

Extended 2020 Claims Period

The cafeteria plan rules require forfeiture of FSA amounts that are unused at the end of a plan year, subject to limited exceptions, including a permissible 2 ½ month grace period. Effective only for the 2020 calendar year, the IRS has given employers the discretion to permit unused FSA amounts from a plan year or grace period ending in 2020 to be applied to claims incurred through **December 31, 2020** (the “Extended 2020 Claims Period”). Given that most employees are concerned with using the FSA deferrals already made in 2020, especially because dependent care centers are largely closed and certain health care procedures have been put on hiatus, the usefulness of this change is unclear.

Notably, however, the IRS’s new guidance permits health FSAs that have a carryover feature, whereby unused amounts may be carried over to the next year, to also take advantage of the Extended 2020 Claims Period. This is notable because prior IRS health FSA rules prohibited health FSAs from having both a carryover feature and a grace period. However, such health FSAs with non-calendar plan years (e.g., July 1, 2019 to June 30, 2020) are still subject to the otherwise applicable carryover limit (discussed below) with respect to amounts carried over from the 2019 plan year and remaining unused after December 31, 2020.

Employers considering adopting the Extended 2020 Claims Period will want to give thought to the impact this may have on the eligibility of covered individuals to participate in health saving accounts, which are not available for individuals who are covered by health FSAs (except certain limited-purpose FSAs).

Increased Health FSA Carryover Limit

For purposes of the carryover limit mentioned above, the cafeteria plan rules set a maximum health FSA amount that can be carried over from year to year. For 2020 and later plan years, the IRS has increased the permissible carryover limit by indexing it for inflation based on a formula linked to the annual health FSA contribution limit. Under this new formula, the maximum amount that may be carried over for the 2020 plan year is $550.

Extended Plan Amendment Deadline

An employer who adopts one more of the above cafeteria plan rule changes must amend its cafeteria plan no later than **December 31, 2021**, and the amendment can be made retroactive to January 1, 2020.   This permitted retroactivity provides relief for employers who may have permitted mid-year election changes prior to the IRS actually issuing their latest guidance.

If you have any questions regarding implementing changes to your cafeteria plan, please contact a member of our Employee Benefits Group.