IRS Provides 125 Plan and Flexible Spending Account Relief in Response to COVID-19

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The Internal Revenue Service (IRS) released Notices 2020-29 and 2020-33 (Notices) on May 12, 2020. The Notices provide relief from certain rules under Section 125 of the Internal Revenue Code due to the COVID-19 pandemic. Specifically, the Notices allow (but do not require) employers to amend 125 plans to (i) allow participants to make mid-year election changes in 2020 that otherwise wouldn't be allowed, (ii) extend "use-it-or-lose-it" deadlines for flexible spending accounts (FSAs) that end in 2020, and (iii) increase carryover amounts for health FSAs. Employers must also amend their plan no later than December 31, 2021 and the amendment can be effective retroactively to January 1, 2020.

Notice 2020-29 – Additional Mid-Year Election Change Events and Extended FSA Claim Deadlines

Additional Mid-Year Election Change Events

Under the normal 125 plan rules, elections must be irrevocable during the entire plan year, unless a change in status event occurs allowing a mid-year election change. These events include termination of employment, significant cost changes, and the addition of a new dependent through birth or adoption. (Note: the IRS and DOL recently issued guidance stating that the period from March 1, 2020 through the end of the national emergency is to be ignored for purposes of deadlines associated with mid-year special enrollment windows.)

Notice 2020-29 provides for five circumstances where an employer may allow (via plan amendment) mid-year election changes that otherwise would not be permitted. Under the new guidance, employees may change their election or make a new election on a prospective basis to:

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- Enroll in an employer's health plan mid-year if the employee originally declined coverage during open enrollment.
- Change their health plan election to enroll in a different plan option and/or enroll dependents.
- Revoke their health plan election, as long as the employee attests in writing that the employee is enrolled (or will immediately enroll) in other coverage not sponsored by the employer. The IRS has provided a template to use for employee attestations.
- Revoke, decrease, make, or increase a health FSA election. This applies to both general and limited purpose health FSAs. The Notice confirms that employer can prohibit an election to decrease health FSA coverage to less than has already been reimbursed.
- Revoke, decrease make, or increase a dependent care FSA election.

Extended FSA Claim Deadlines

Normally, FSAs are required to comply with the use-it-or-lose-it rule which requires amounts participants have not spent by the end of a plan year to be forfeited. IRS does allow health FSAs to implement either a (i) grace period (where an FSA participant has 2 ½ months after the end of the plan year to incur claims and use amounts contributed during the plan year to pay for such claims), or, for health FSAs only, a carryover (which allows a health FSA participant to carry over up to $500 contributed to an FSA during the plan year to be used for expenses in the next plan year).

Notice 2020-29 has relaxed the use-it-or-lose-it rule to allow extended timeframes to submit claims to a health or dependent care FSA. Under this relaxed rule, employers may amend their 125 plans to allow participants to use amounts remaining in an FSA at the end of a grace period or plan year that ends in 2020, for claims incurred through December 31, 2020. This extension applies to all FSAs, even those that do not offer grace periods. However, a calendar plan year health FSA with a carryover will not benefits from this extended period because its plan year ends December 31,

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2020.

The IRS did not provide relief from the HSA rules. If a general purpose health FSA has an extended use-it-or-lose-it deadline, the participant will not be eligible for a health savings account (HSA) during those additional months when FSA expenses can be incurred under the extended deadline. This can be avoided by allowing the participant to elect limited purpose FSA coverage or to waive the extended deadline. As of now, it looks like a participant that has the entire 2020 calendar year to spend down a general purpose health FSA will not be eligible for an HSA at all during 2020.

Notice 2020-33 – Increased Health FSA Carryovers

The Notice also allows for increased carryover amounts for health FSAs that allow carryovers. The IRS has increased the $500 limit for 2020 and later years to an amount equal to 20% of the maximum health FSA salary reduction contribution for the plan year (indexed in $10 increments), which is $550 for 2020. Therefore, a health FSA participant in a plan with a carryover feature can carryover up to $550 contributed in 2020 to 2021, as long as the employer offers this option and amends the plan by the end of the 2021 plan year.

As noted above, these changes are optional for employers. A plan can be amended to implement all of these rules, none of them, or just a few.

Please contact Carl Lammers or another attorney in Frost Brown Todd's Employee Benefits & ERISA practice group if you have questions about any of the COVID-19-related relief applicable to 125 plans.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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