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IRS expands permissible mid-year cafeteria plan election changes

To assist employees affected by the COVID-19 outbreak, the IRS has significantly increased employer flexibility in allowing mid-year election changes for cafeteria plans, health FSAs and dependent care FSAs. These changes are optional for employers and are only effective for 2020.

Background

Section 125 of the Internal Revenue Code, which governs cafeteria plans, authorizes employees to be given the choice between receiving cash or certain non-taxable qualified benefits and to pay for those benefits on a pretax basis. Qualified benefits include health coverage, health flexible spending accounts (FSAs) and dependent care flexible FSAs.

Elections regarding qualified benefits offered through a cafeteria plan must be irrevocable for the entire plan year. Regulations under Section 125 authorize, but generally do not require, a cafeteria plan to permit mid-year election changes under certain specified circumstances. Permitted election changes must be set out in the cafeteria plan document and communicated to employees.

During the COVID-19 crisis, some employees have wanted to modify their current benefit elections to reflect changes in their circumstances or benefit needs that are not authorized under current Section 125 guidance. These changes include not only the need of employees and their family members for health coverage, but also their need for or ability to utilize funds in their health FSAs or dependent care FSAs. Employers have been unsure how to address these requests.

In [Notice 2020-29](#), the Internal Revenue Service significantly increased employer flexibility in allowing mid-year election changes for cafeteria plans, health FSAs and dependent care FSAs. The scope of this guidance is described below.

Volume 43

Issue 28

May 14, 2020

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Permitted cafeteria plan elections

The notice permits employers to allow employees to make certain mid-year election changes during 2020 for health coverage, health FSAs and dependent care FSAs that might not otherwise be permitted under existing cafeteria plan rules. An employer can amend its plan to allow employees to:

- Make a new election to enroll in health coverage if the employee initially declined coverage
- Revoke an existing health coverage election and make an election to enroll in different health coverage with the same employer, including changing coverage from self-only to family coverage
- Revoke an existing health coverage election and enroll in health coverage not sponsored by the employer, provided that the employee attests in writing that he or she is enrolled, or immediately will enroll, in that other health coverage (guidance includes a sample employee attestation)
- Revoke an election, make a new election, or decrease or increase an existing election for a health FSA or a dependent care FSA

All election changes must be made on prospective basis.

An employer is not required to permit employees to make these elections changes — it can determine which will be allowed and whether it will impose any limitations on them. Any plan changes must comply with cafeteria plan nondiscrimination rules.

Buck comment. To control potential adverse selection, the employer may want to limit the election changes that employees can make.

Recognizing that some cafeteria plans may have permitted employees to make similar election changes prior to the issuance of the notice in response to COVID-19, the IRS states that the relief applies retroactively to cafeteria plans that permitted mid-year election changes consistent with the guidance on or after January 1, 2020.

Extended period for incurring claims under health and dependent care FSAs

The notice allows (but does not require) an employer to amend its cafeteria plan to permit amounts remaining in an employee's health FSA or dependent care FSA as of the last day of a grace period ending in 2020, or as of the last day of plan year ending in 2020, to be used to reimburse eligible expenses incurred through December 31, 2020. The extended period for incurring claims applies both to plans that have a grace period and to those that provide for a carryover.

Buck comment. The practical effect of the guidance on a calendar year plan with a grace period is to extend that period for the 2019 plan year through December 31, 2020. Although this could be beneficial to employees, the extension of the grace period of a general-purpose health FSA could potentially make the employee ineligible to contribute to an HSA for all of 2020.

The relief may be applied retroactively to periods beginning on or after January 1, 2020 and ending on December 31, 2020.

Plan amendments

An employer will have to amend its cafeteria plan to authorize any changes permitted by the notice that it chooses to implement. An amendment for the 2020 plan year must be adopted by December 31, 2021. The changes can be retroactive to January 1, 2020 provided the cafeteria plan operates in accordance with guidance and the employer communicates the changes to all eligible employees.

In closing

This guidance significantly increases the ability of employers to help employees in utilizing their benefits during 2020.

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