



More Participant-Friendly Guidance from IRS in Light of COVID – This Time, It’s Cafeteria Plans

June 10, 2020

On May 12, 2020, the IRS issued Notice 2020-29, which adds flexibility to the rules governing cafeteria plans under Section 125 of the Internal Revenue Code. As with other benefits-related guidance issued in connection with COVID-19, the rules in the Notice apply on a temporary basis and are discretionary. Employers are free to adopt them or not, and if they do, can tailor them to suit their goals.

Cafeteria plans allow employees to pay for certain benefits, for example, the employee's portion of employer-sponsored health plan premiums and eligible health and dependent care expenses, on a pre-tax basis. This can result in important cost savings to employees who participate in them. In order to take advantage of this tax benefit, though, the plan needs to follow certain rules. One of these rules is that elections to participate in the plan have to be made by the employee before the beginning of the plan year. For example, for a cafeteria plan with a plan year that begins on January 1, 2020, employee elections to participate have to be made no later than December 31, 2019. The election specifies the amount that an employee wishes to contribute to the plan for the 2020 plan year.

There are some limited exceptions to this rule allowing an employee to change an election during the plan year to increase, decrease or cease contributions. The exceptions include a change in family status or if there is a significant change in the cost of coverage during the plan year. Otherwise, once the employee makes the election, no changes are permitted for the plan year. And, if an employee elects to contribute an amount for a plan year that the employee does not use for an allowable plan expense, the employee forfeits this amount.

Mid-Year Changes to Employer-Sponsored Health Plan Elections and Cafeteria Plan Contribution Levels Permitted Under Notice 2020-29

In recognition of the special circumstances presented by the COVID-19 crisis, Notice 2020-29 loosens these rules. First, with respect to employer-sponsored health coverage, Notice 2020-29 allows employer discretion to permit employees to: (1) make a new election on a prospective basis to participate in the employer's health plan if the employee initially declined to do so; (2) revoke an existing election and make a new election on a prospective basis to enroll in a different level of health coverage sponsored by the employer; or (3) completely revoke an existing election, 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. Importantly, Notice 2020-29 provides a vehicle through which employees can adjust their cafeteria plan contributions mid-year to coordinate with any of the above changes. So, for example, assuming the plan allows it, and an employee wishes to change from one level of employer coverage to another, more expensive, level the employee can change his or her cafeteria plan election in 2020 going forward to coordinate with the increased expense so that the increase can still be accomplished on a pre-tax basis.

For certain other cafeteria plan benefits, i.e., flexible spending accounts for eligible health and dependent care expenses, Notice 2020-29 allows employers to permit employees to make an election mid-year for any reason. Accordingly, an employee who elected to contribute a larger amount to his or her health care flexible spending account for 2020 to assist in payment of an anticipated non-urgent medical procedure, which could not be scheduled because of the COVID-19 crisis, could elect to reduce his or her contributions to the health care flexible spending account for the rest of the year to reduce the participant's total contributions for the year.

Extended Grace Period to Spend Otherwise Forfeited Cafeteria Plan Amounts

Notice 2020-29 also liberalizes the cafeteria plan carryover rules. Under current law, cafeteria plans are permitted to allow a 2-1/2 month grace period after the end of a plan year to use dollars that the employee was unable to use during the plan year for permitted health and dependent care expenses. Notice 2020-29 allows employers to extend this grace period until the end of 2020, permitting employees more time to use the dollars. Accordingly, if the employer's plan currently allows for a grace period, the employer could amend its plan to allow unused amounts for the 2019 plan year to be used up until December 31, 2020. Note, though, that the extension may prevent an individual from making health savings account (HSA) contributions for all of 2020 since the grace period (now extended) is considered a period of disqualifying coverage under a health care flexible spending account (generally incompatible with the ability to make an HSA contribution, except in the case of a limited purpose flexible spending account).

Recommendations for Employers Adopting Modified Rules Under Notice 2020-29

As mentioned above, none of the changes permitted by Notice 2020-29 are required. An employer is permitted to adopt them and to add reasonable restrictions in its discretion. For example, if an employer decides to allow a mid-year election change, it may want to provide a specified period of time during which the election must be made.

For any mid-year changes in health coverage, the employer will want to communicate with its insurer (if insured) and stop loss carrier (if self-insured) to make sure the insurer agrees to the changes and that they can be implemented effectively. If an employer wants to make any of these changes, it will need to formally



adopt an amendment to accomplish them. The Notice grants a fairly generous amount of time to do this. The amendment must be adopted by December 31, 2021. However, employers who adopt any of these changes will want to notify plan participants about the changes as soon as possible. ERISA plans can accomplish the notice through a summary of material modifications (SMM), which supplements the participant's summary plan description (SPD) for the plan.

If you have any questions about the above, or the changing legal landscape for employee benefits plans due to COVID-19 in general, please contact Virginia Schubert, John Nichols, Greg Kuhn, or your regular Lathrop GPM contact.