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To: [SBLC Net](#)
Cc: "44930_0000 - Small Business Legislative Cou 2020"
Subject: SBLC - IRS Issues New Rules Impacting FSA and HRA Plans [IWOV-PaleyDocs.FID625574]
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Dear SBLC Members,

For those of you who are interested, we wanted to share with you the below piece which was recently distributed by the Small Business Council of America which is a long time SBLC member. The piece was authored by the SBCA's President, Gary Kushner, who is an expert in the employee benefits area and is dealing with new rules impacting cafeteria (section 125) plans.

As a reminder, if your association has put out any materials that you think would be of general interest or help to your fellow SBLC members we encourage you to share them with us.

Best,
Paula and Jessie

Provided by:
Gary Kushner, SBCA President
<https://www.kushnerco.com/irs-issues-new-rules-impacting-fsas-and-hras>
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IRS ISSUES NEW RULES IMPACTING FSA AND HRA PLANS

MAY 19, 2020

In two new IRS Notices ([2020-29](#) and [2020-33](#)) issued on May 12, 2020, there are temporary changes to the rules governing Flexible Spending Accounts (FSAs) through 2020 due to COVID-19, and permanent changes to both FSAs and certain Health Reimbursement Arrangements (HRAs) that will begin this year and extend forward into the future.

Notice 2020-29 – COVID-19, Group Health Plan Elections, and IRS Section 125 Plans

This Notice provides for increased flexibility with respect to mid-year elections under a §125 cafeteria plan only during calendar year 2020 related to employer sponsored health coverage, health Flexible Spending Accounts (health FSAs), and dependent care assistance programs (dependent care FSAs). This Notice also provides increased flexibility with respect to grace periods to apply unused amounts in health FSAs to medical care expenses incurred through December 31, 2020, and unused amounts in dependent care assistance programs to dependent care expenses incurred through December 31, 2020.

According to the “regular” rules on cafeteria plans, participant elections must be made before the start of the plan year (or before the start of coverage for a newly eligible participant), and with limited exceptions must be irrevocable for the remainder of the plan year. Under this Notice, a cafeteria plan may optionally allow mid-year election changes made during calendar year 2020 to permit employees who are eligible to make salary reduction contributions under the plan to:

1. With respect to employer-sponsored health coverage
 - a. make a new election on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage;
 - b. revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis; and
 - c. revoke an existing election 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, such as another group health plan, Medicaid, Medicare, or individual health coverage,
2. With respect to a health care FSA or dependent care FSA:
 - a. revoke an election, make a new election, or decrease or increase an existing election on a prospective basis.

We should point out that these new temporary abilities of a plan during 2020 are optional and not mandatory. Many employers, for instance, will want to enable employees to enroll or revoke an enrollment election in various group health plan options offered by the employer. Similarly, many employers would embrace enabling dependent care FSA participants to increase (or more likely, decrease or revoke) their elections if schools and day care centers are closed, or if the employee is working from home. However, due to current IRS rules around the so-called “risk shift” regulations impacting health care FSAs, employers may be more reluctant to enable employees to decrease or even revoke their election, in particular if they’ve already claimed their previous full election amount and payments have been disbursed. Imagine a health care FSA plan participant who has already submitted claims for their full \$2,750 election earlier in 2020, who now wishes to revoke their election after only making four months of contributions. To that end, the Notice allows employers to limit, for example, a health care FSA decreased election to no less than amounts already reimbursed in 2020.

Next, the Notice optionally allows for an extension for incurring and filing of claims during an FSA’s grace period that ends in 2020 or runoff period until the end of 2020. For example, if a calendar year plan for 2019 has a grace period where FSA participants could have incurred eligible expenses until March 15, 2020, this Notice could allow the plan to extend the grace period until December 31, 2020 so that claims incurred at any time in 2020 could be applied to any remaining 2019 plan balances. Like the temporary changes allowed regarding elections above, this provision only applies in 2020, and would not apply in 2021 or thereafter, barring any subsequent changes to the Notice.

Lastly, for FSAs that have carryover provision instead of a grace period (by prior regulations a plan cannot have both, and still cannot), a carryover period that ends during 2020 may also optionally allow the employee to extend the submission (and incurring) of claims to the end of 2020. Thus, an FSA with a July 1, 2019 to June 30, 2020 plan year with carryover provisions

could enable a participant to incur and submit claims through December 31, 2020 for that 2019 plan year. There is a prior \$500 cap on carryover amounts for that 2019 plan year (but stay tuned in the next section for yet another upcoming change).

Example 1

Slate Rock and Gravel Company sponsors a health care FSA with a 2019 plan year that runs July 1, 2019 to June 30, 2020. The plan has a provision allowing up to a \$500 carryover of unused funds into the following plan year. Slate Rock and Gravel chooses to amend its plan to adopt the temporary extended period for incurring claims with respect to the 2019 plan year, allowing for claims incurred prior to January 1, 2021 to be paid with amounts remaining from the 2019 plan year.

Barney Rubble has a remaining balance in his health FSA for the 2019 plan year of \$2,000 on June 30, 2020, because a scheduled non-emergency procedure on his driving foot was postponed. For the 2020 plan year beginning July 1, 2020, Barney elects to contribute another \$2,000 to his health FSA. Barney is able to reschedule the procedure before December 31, 2020 and, between July 1, 2020 and December 31, 2020, he incurs \$1,900 in eligible unreimbursed medical expenses. The health FSA may reimburse Barney \$1,900 from the \$2,000 remaining in his health FSA at the end of the 2019 plan year, leaving \$100 unused from

the 2019 plan year. Under the plan terms that provide for a carryover, Barney is allowed to use the remaining \$100 in his health FSA until June 30, 2021 to reimburse claims incurred during the 2020 plan year. Barney can also be reimbursed for up to \$2,100 (\$2,000 contributed to the health FSA for the 2020 plan year plus \$100 carryover from the 2019 plan year) for eligible unreimbursed medical expenses incurred between January 1, 2021 and June 30, 2021. In addition, Barney may carry over to the 2021 plan year beginning July 1, 2021 up to \$550 (you thought the limit was \$500...you'll want to read the description of the next Notice below) of any remaining portion of that \$2,100 after claims are processed for the 2020 plan year that began July 1, 2020. A grace period is not available for the plan year ending June 30, 2021 since the plan has carryover provisions.

Example 2

Same facts as Example 1, except that Barney's best friend Fred has a remaining balance in his health FSA for the 2019 plan year of \$1,250 on June 30, 2020. For the 2020 plan year beginning July 1, 2020, Fred elects to contribute \$1,200 to his health FSA. Between July 1, 2020 and December 31, 2020, Fred incurs \$600 in medical expenses. The health FSA may reimburse Fred \$600 from the \$1,250 remaining in his health FSA at the end of the 2019 plan year, leaving \$650 unused from the 2019 plan year. Under the plan terms, Fred is allowed to use \$500 of the \$650 unused amount from the 2019 plan year to reimburse claims incurred during the 2020 plan year, and the remaining \$150 will be forfeited [Note: Wait. In example 1 you said the carryover limit was \$550. True, but that was for the 2020 plan year that started July 1, 2020. For the 2019 plan year, the carryover limit is still the old \$500]. Fred may be reimbursed for up to \$1,700 (\$1,200 contributed to the health FSA for the 2020 plan year plus \$500 carryover from the 2019 plan year) for medical expenses incurred between January 1, 2021 and June 30, 2021. In addition, Fred may carry over to the 2021 plan year beginning July 1, 2021 up to \$550 of any remaining unused portion of that \$1,700 after claims are processed

for the 2020 plan year that began July 1, 2020. Like in Example 1, a grace period is not available for the plan year ending June 30, 2021.

No Change to “Regular” Health Care FSA Grace Period Disqualifying HSA Contributions

The Notice reiterates the IRS’ previous position that a health care FSA with a grace period is a non-HDHP plan, and thus disqualifies both the employer and employee from making HSA contributions during the grace period, or in this temporary case, during the extended claims time. Thus, a plan that is amended to utilize the extended claims time during 2020 to extend a grace period would disqualify a participant or his or her employer from making HSA contributions throughout all of 2020.

Plan Amendments to Accommodate These Temporary Changes

If an employer wishes to utilize any of these benefits provided in the Notice (2020 mid-year election changes or revocations, and/or extended claims periods), it must amend its plan document by no later than December 31, 2021, and the amendment can be retroactive to January 1, 2020.

Notice 2020-33 (Part 1) – Health FSA Carryover Amount Indexing

This second notice issued the same day for the first time provides a permanent indexing feature to the allowable carryover of unused health care FSA balances from one plan year to the next.

Historically, all health care FSAs were subject to a strict “use it or lose it” rule each plan year. That is, after the end of the plan year and any subsequent runoff period in which participants could submit claims for the prior plan year, balances remaining in a health FSA were required to be forfeited. They couldn’t be paid out as taxable cash, nor with a very narrow exception could they be returned in any form unless spread across all participants evenly. In 2013, the IRS slightly liberalized the rule and allowed plans to optionally adopt a carryover of up to \$500 of unused health care FSA balances for use in the next plan year, without reducing the overall amount that a participant could elect to contribute for that next year.

With this Notice, the IRS is providing for an indexing feature for the \$500 carryover. Starting for plan years that begin on or after January 1, 2020, the carryover amount is indexed. Thus, a plan that adopts a carryover provision can allow for up to \$550 from the plan year that begins during 2020 into the 2021 plan year.

Notice 2020-33 (Part 2) – Pre-Tax Individual Coverage HRA (ICHRA) Payments

But wait, that’s not all. The same IRS Notice addresses an operational issue that impacts the new ICHRA plans that an employer can adopt to enable employees not eligible for the employer’s group health plan to purchase individual (non-group) health coverage pre-tax at the Exchange or available outside of the Exchange, or for Medicare Parts B and D. These new ICHRAs were first available to employers beginning on or after January 1, 2020. [To read more about ICHRAs, click [here](#).]

The issue that this Notice addresses is a timing one: can a participant’s payment made before coverage actually begins be reimbursed from the ICHRA tax-free? For example, for a calendar year ICHRA, is a participant’s payment for January coverage paid in December eligible for reimbursement? Similarly, for a new participant who joins the ICHRA mid-month, can a payment made prior to the date coverage starts be reimbursed?

This Notice says the answer to both questions is “yes.” Thus, for example, an individual coverage HRA with a calendar year plan year may immediately reimburse a substantiated premium for individual health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium in December.

Employer Actions to Take Now

1. In conjunction with the employer’s group health plan insurer or TPA and stop-loss vendor, determine if the optional changes for 2020 only for participants’ mid-year group health coverage revocation, changes (employee-only to family coverage, for example), or new elections will be allowed, even absent a change of status that would qualify for a HIPAA Special Enrollment Period.
2. For 2020 only for each of the FSAs (health and dependent care), decide if the plan will allow mid-year revocations, increases, and/or decreases in the elected amounts. If decreases are to be allowed for the health care FSA, decide if the plan will impose a limit of the decrease only to the amounts already reimbursed year-to-date, rather than a lesser amount or a complete revocation of the election.
3. Decide for 2020 only if an FSA will allow for the optional extended time through December 31, 2020 for participants to incur and submit claims for the prior plan year.
4. Consult with your FSA plan vendor about making the operational changes in #2 and #3 and the communications to plan participants. Further, consult with the vendor or your benefits legal counsel to make the required plan amendments to implement those options.
5. If your health care FSA has a carryover provision, begin planning your employee communications in preparation for the 2021 plan year for an increased carryover amount. This may also necessitate a plan amendment to change from a flat \$500 carryover provision to an amount “as determined each year by the IRS.”
6. If you sponsor an ICHRA, work in conjunction with that plan vendor to implement the ability to reimburse payments made prior to coverage, and prepare a communication to employees clarifying how individual health coverage reimbursements can now be made under the ICHRA.