SAN FRANCISCO
HEALTH SERVICE SYSTEM
Affordable, Quality Benefits & Well-Being

ADDENDUM to San Francisco Health Service System ("HSS") Section 125 Cafeteria Plan and HSS System Member Rules for Plan Year 2020
May 28, 2020

Purpose: To assist with the nation's response to the 2019 Novel Coronavirus outbreak ("COVID-19"), the IRS has provided guidance under Notices 2020-29 and 2020-33 increasing flexibility with respect to mid-year elections under a Section 125 cafeteria plan during calendar year 2020 related to employer sponsored health coverage, health Flexible Spending Arrangements (health FSAs), and dependent care assistance programs. This Addendum modifies the HSS Section 125 Cafeteria Plan and Member Rules consistent with IRS Notices 2020-29 and 2020-33

Revision of 2020 SFHSS Member Rules and Cafeteria Plan: Based on guidance from IRS Notice 2020-29, employees and retirees who are eligible for SFHSS benefits can make the following mid-year elections changes once* during calendar year 2020 without a qualifying event:

(1) with respect to employer-sponsored health coverage (medical, dental and vision 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 plan or coverage level sponsored by the same employer on a prospective basis; and
(c) revoke an existing election on a prospective basis provided, however, that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer;

(2) revoke an election, make a new election, or decrease or increase an existing election applicable to a health FSA on a prospective basis; and

(3) revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program on a prospective basis.

Revision of Carryover Provision for 2021 SFHSS Member Rules and Cafeteria Plan: Based on IRS Notice 2020-33, eligible HSS members are permitted to carryover unused amounts remaining in a health FSA as of the end of a plan year to pay, or reimburse, a participant for medical care expenses incurred during the following plan year, subject to the carryover limit of $550 for 2021. [The carryover limit for 2020 is $500].

*An employer is not required to provide unlimited election changes but may, in its discretion, determine which election changes are permitted provided, however, that any permitted election changes are applied on a prospective basis only, and the changes to the plan's election requirements do not result in a failure to comply with the applicable Section 125 cafeteria plan nondiscrimination rules.

Section 125 Cafeteria Plans - Modification of Permissive Carryover Rule for Health Flexible Spending Arrangements and Clarification Regarding Reimbursements of Premiums by Individual Coverage Health Reimbursement Arrangements

Notice 2020-33

I. PURPOSE

This notice modifies Notice 2013-71, 2013-47 IRB 532, to increase the carryover limit (currently $500) of unused amounts remaining as of the end of a plan year in a health Flexible Spending Arrangement (health FSA) under a § 125 cafeteria plan that may be carried over to pay or reimburse a participant for medical care expenses incurred during the following plan year. The increase in the amount that can be carried over from one plan year to the next reflects indexing for inflation, and this indexing parallels the indexing applicable to the limit on salary reduction contributions under § 125(i) of the Internal Revenue Code (Code). Second, this notice clarifies the ability of a health plan to reimburse individual insurance policy premium expenses incurred prior to the beginning of the plan year for coverage provided during the plan year. This clarification will assist with the implementation of individual coverage health reimbursement arrangements (individual coverage HRAs).

II. BACKGROUND

Section 125(d)(1) defines a § 125 cafeteria plan as a written plan maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Subject to certain exceptions, § 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code. Qualified benefits include employer-provided

accident and health plans excludable from gross income under §§ 106 and 105(b), but exclude long term care insurance and certain qualified health plans offered through an Exchange (also referred to as a Marketplace) established under § 1311 of the Patient Protection and Affordable Care Act (the Act).[1]

Qualified health and accident benefits provided under a § 125 cafeteria plan and reimbursements of medical care expenses by an HRA or any other accident and health plan are subject to the rules for the exclusions from gross income under §§ 105 and 106. An amount generally will be treated as received under an accident and health plan only if the employee was covered by the plan on the date the employee became sick or injured. Treas. Reg. § 1.105-5. Thus, only reimbursements for medical care expenses incurred by a participant during the plan year may be excluded from income and wages under §§ 105 and 106.

Section 125(i) provides that, beginning in 2013, a health FSA is not treated as a qualified benefit unless the § 125 cafeteria plan limits each employee's salary reduction contribution to the health FSA to no more than $2,500 per taxable year (as indexed for cost-of-living adjustments, $2,750 for 2020).[2] Notice 2012-40, 2012-26 IRB 1046, clarifies that the term "taxable year" in § 125(i) refers to the plan year of the § 125 cafeteria plan, so that the limit is applicable beginning with the first day of the first plan year beginning in 2013.

A. The permissive carryover rule

Pursuant to § 125(d)(2)(A), a § 125 cafeteria plan generally does not include any plan that provides for deferred compensation. Consistent with this statutory rule,

[1] Public Law 111-148 (124 Stat. 1029 (2010)), amended by §§ 10104 and 10203 of the Act.
[2] Revenue Procedure 2019-44, 2019-47 IRB 1093.

proposed regulations under § 125 (that predate the enactment of the Act and provide that taxpayers may rely upon them pending further guidance) generally prohibit participants from using contributions made for one plan year to purchase a benefit that will be provided in a subsequent plan year because using contributions in this manner would result in a deferral of compensation. To satisfy the statutory requirement, and in reliance on the proposed regulations, plans adopted a "use-or-lose" rule under which unused benefits or contributions remaining as of the end of the plan year (referred to in this notice as "unused amount(s)") are forfeited. See Prop. Treas. Reg. §§ 1.125-1(c)(7)(C), 1.125-1(o), and 1.125-5(c). To address the need for a period after the end of the plan year during which participants may submit documentation for expenses incurred throughout the entire plan year, the proposed regulations provide for a "run-out period." A "run-out period" is a period immediately following the end of a plan year during which a participant can submit a claim for reimbursement of expenses incurred for qualified benefits during the plan year or, in the case of a plan using the grace period rule (described in the following paragraph), such a period immediately following the end of the grace period. See Prop. Treas. Reg. § 1.125-1(f). Plans commonly rely on this rule to calculate the unused amounts as of the end of a health FSA's plan year. The unused amounts are calculated as the amounts that remain after medical care expenses have been reimbursed at the end of the plan's run-out period for that plan year.

In 2005, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) liberalized the use-or-lose rule by providing a grace period rule. Under the grace period rule, a § 125 cafeteria plan may permit a participant to apply

COVID-19 GUIDANCE UNDER § 125 CAFETERIA PLANS AND RELATED TO HIGH DEDUCTIBLE HEALTH PLANS

Notice 2020-29

I. PURPOSE AND OVERVIEW

To assist with the nation's response to the 2019 Novel Coronavirus outbreak (COVID-19), this notice provides for increased flexibility with respect to mid-year elections under a § 125 cafeteria plan during calendar year 2020 related to employer-sponsored health coverage, health Flexible Spending Arrangements (health FSAs), and dependent care assistance programs. 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.

As described more fully below, this notice provides that –

- For mid-year elections made during calendar year 2020, a § 125 cafeteria plan may 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; (2) revoke an election, make a new election, or decrease or increase an existing election applicable to a health FSA on a prospective basis; and (3) revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program on a prospective basis;

- For unused amounts remaining in a health FSA or a dependent care assistance program under the § 125 cafeteria plan as of the end of a grace period or plan year ending in 2020, a § 125 cafeteria plan may permit employees to apply those unused amounts to pay or reimburse medical care expenses or dependent care expenses, respectively, incurred through December 31, 2020; and
- The relief provided in Notice 2020-15, 2020-14 IRB 559 regarding high deductible health plans (HDHPs) and expenses related to COVID-19, and in section 3701 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (P.L. 116-136, 134 Stat. 281 (March 27, 2020)) regarding an exemption for telehealth services, may be applied retroactively to January 1, 2020.

II. BACKGROUND

A. Elections Under a § 125 Cafeteria Plan

Section 125(d)(1) of the Internal Revenue Code (Code) defines a § 125 cafeteria plan as a written plan maintained by an employer under which all participants are

employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Subject to certain exceptions, § 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code. Qualified benefits that may be provided under a § 125 cafeteria plan include employer-provided accident and health plans excludable under §§ 106 and 105(b), health FSAs excludable under §§ 106 and 105(b), and dependent care assistance programs excludable under § 129.

Elections regarding qualified benefits under a § 125 cafeteria plan generally must be irrevocable and must be made prior to the first day of the plan year, except as provided under Treas. Reg. § 1.125-4.[1] Treas. Reg. § 1.125-4 provides that a § 125 cafeteria plan may permit an employee to revoke an election during a period of coverage and to make a new election under certain circumstances, such as if the employee experiences a change in status or there are significant changes in the cost of coverage. Section 125 does not require a § 125 cafeteria plan to permit the mid-year election changes allowed under Treas. Reg. § 1.125-4.

Due to the nature of the public health emergency posed by COVID-19 and unanticipated changes in the need for medical care, some employers have indicated a willingness to offer employees who initially declined to elect employer-sponsored health coverage an opportunity to elect health coverage or allow employees enrolled in

[1] In contrast, for qualified transportation fringe benefits under § 132(f) (which pursuant to § 125(f)(1) may not be offered under a § 125 cafeteria plan), Treas. Reg. § 1.132-9, Q&A 14 provides that employees may change or revoke compensation reduction elections related to the qualified transportation fringe benefits under § 132(f) before the employee is able currently to receive the cash or other taxable amount at the employee's discretion (generally before the beginning of a pay period).

employer-sponsored health coverage to enroll in different health coverage offered by the same employer or drop their existing employer-sponsored health coverage to enroll in other health coverage not offered by their employer (for example, coverage offered by their spouse's employer). In addition, some employees may have an increase or decrease in medical expenses due to unanticipated changes in the need for or availability of medical care and may wish to increase or decrease amounts in their health FSAs. Further, some employees may have an increase or decrease in the need for dependent care assistance due to the unanticipated closure of schools and child care providers and changes to the employee's work location or schedule. Depending on an employee's circumstances, the exceptions set forth in Treas. Reg. § 1.125-4 may not apply with respect to election changes that employees may wish to request for employer-sponsored health coverage, health FSAs, and dependent care assistance programs for reasons related to the COVID-19 public health emergency.

B. Health FSAs and Dependent Care Assistance Programs

Under the carryover rule, a § 125 cafeteria plan may permit the carryover of unused amounts remaining in a health FSA as of the end of a plan year to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to the carryover limit (currently $550). See Notice 2013-71, 2013-47 IRB 532, and Notice 2020-33, 2020-22 IRB ___. Under the grace period rule, a § 125 cafeteria plan may permit a participant to apply unused amounts (including amounts remaining in a health FSA or dependent care assistance program) at the end of a plan year to pay expenses incurred for those same qualified benefits during the period of up to two months and 15 days immediately following the end of the plan year. See

Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. § 1.125-1(e). For a health FSA, a § 125 cafeteria plan may adopt a carryover or a grace period (or neither), but may not adopt both features. See Notice 2013-71.

Due to the nature of the public health emergency posed by COVID-19, in particular unanticipated changes in the availability of certain medical care and dependent care, employees may be more likely to have unused health FSA amounts or dependent care assistance program amounts (or have larger unused health FSA amounts or dependent care assistance program amounts) as of the end of plan years, or grace periods, ending in 2020 and may wish to have an extended period during which to apply their unused health FSA amounts or dependent care assistance program amounts to pay or reimburse medical care expenses or dependent care expenses.

C. Impact of Health FSA Reimbursements on Eligibility to Contribute to an HSA

Section 223 permits eligible individuals to establish and contribute to health savings accounts (HSAs). Pursuant to § 223(c)(1)(A), an eligible individual is, with respect to any month, any individual if (i) such individual is covered under an HDHP as of the first day of such month, and (ii) such individual is not, while covered under an HDHP, covered under any health plan which is not an HDHP, and which provides coverage for any benefit which is covered under the HDHP. An HDHP is a health plan that satisfies the minimum annual deductible requirement and maximum out-of-pocket expenses requirement under § 223(c)(2)(A).

Coverage by a general purpose health FSA is coverage by a health plan that disqualifies an otherwise eligible individual from contributing to an HSA, although coverage by a limited purpose health FSA would not do so.[2] See Rev. Rul. 2004-45, 2004-1 C.B. 971. Similarly, a telemedicine arrangement generally constitutes a health plan or insurance that provides coverage before the minimum annual deductible is met, and provides coverage that is not disregarded coverage or preventive care, which would generally disqualify an otherwise eligible individual from contributing to an HSA. However, section 3701 of the CARES Act amended § 223 of the Code to temporarily allow HSA-eligible HDHPs to cover telehealth and other remote care services. See section IV.B. of this notice for more details.

III. RELIEF

A. Elections Under a § 125 Cafeteria Plan

This notice provides temporary flexibility for § 125 cafeteria plans to permit employees to make certain prospective mid-year election changes for employer-sponsored health coverage, health FSAs, and dependent care assistance programs during calendar year 2020 that the plan chooses to permit. Specifically, an employer, in its discretion, may amend one or more of its § 125 cafeteria plans (including limiting the period during which election changes may be made) to allow each employee who is eligible to make salary reduction contributions under the plan to make prospective

[2] Notice 2005-86, 2005-49 IRB 1075 clarifies that coverage by a general purpose health FSA during a grace period is health coverage that disqualifies an otherwise eligible individual from contributing to an HSA during that period. However, Notice 2005-86 provides methods an employer can use to amend the health FSA for the grace period so it does not disqualify employees from contributing to an HSA during that period.

election changes (including an initial election) during calendar year 2020 regarding employer-sponsored health coverage, a health FSA, or a dependent care assistance program, regardless of whether the basis for the election change satisfies the criteria set forth in Treas. Reg. § 1.125-4. In particular, an employer may amend one or more of its § 125 cafeteria plans to allow employees to: (1) make a new election for employer-sponsored health coverage on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage; (2) revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis (including changing enrollment from self-only coverage to family coverage); (3) revoke an existing election for employer-sponsored health coverage 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; (4) revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA on a prospective basis; and (5) revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program on a prospective basis.

To accept an employee's revocation of an existing election for employer-sponsored health coverage, the employer must receive from the employee an attestation in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer. The employer may rely on the written attestation provided by the employee, unless the employer has actual knowledge that the employee is not, or will not be, enrolled in other comprehensive

health coverage not sponsored by the employer. The following is an example of an acceptable written attestation:

> Name: _____ (and other identifying information requested by the employer for administrative purposes).
>
> I attest that I am enrolled in, or immediately will enroll in, one of the following types of coverage: (1) employer-sponsored health coverage through the employer of my spouse or parent; (2) individual health insurance coverage enrolled in through the Health Insurance Marketplace (also known as the Health Insurance Exchange); (3) Medicaid; (4) Medicare; (5) TRICARE; (6) Civilian Health and Medical Program of the Department of Veterans Affairs (CHAMPVA); or (7) other coverage that provides comprehensive health benefits (for example, health insurance purchased directly from an insurance company or health insurance provided through a student health plan).
>
> Signature: _____

An employer utilizing this relief under § 125 is not required to provide unlimited election changes but may, in its discretion, determine the extent to which such election changes are permitted and applied, provided that any permitted election changes are applied on a prospective basis only, and the changes to the plan's election requirements do not result in failure to comply with the nondiscrimination rules applicable to § 125 cafeteria plans. In determining the extent to which election changes are permitted and applied, an employer may wish to consider the potential for adverse selection of health coverage by employees. To prevent adverse selection of health coverage, an employer may wish to limit elections to circumstances in which an employee's coverage will be increased or improved as a result of the election (for example, by electing to switch from self-only coverage to family coverage, or from a low option plan covering in-network expenses only to a high option plan covering expenses in or out of network). Changes to the plan may also implicate other applicable laws,

such as notice requirements under Title I of the Employee Retirement Income Security Act of 1974, with which any changes should comply. With respect to mid-year election changes for employer-sponsored coverage, this relief applies to both employers sponsoring self-insured plans and employers sponsoring insured plans. With respect to health FSAs, this relief applies to all health FSAs, including limited purpose health FSAs compatible with HSAs. In addition, with respect to health FSAs and dependent care assistance programs, employers are permitted to limit mid-year elections to amounts no less than amounts already reimbursed.

This relief may be applied retroactively to periods prior to the issuance of this notice and on or after January 1, 2020, to address a § 125 cafeteria plan that, prior to the issuance of this notice, permitted mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs that otherwise are consistent with the requirements for the relief provided in this notice.

B. Extended Claims Period for Health FSAs and Dependent Care Assistance Programs

This notice also provides flexibility for a § 125 cafeteria plan to provide an extended period to apply unused amounts remaining in a health FSA or dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses. Specifically, an employer, in its discretion, may amend one or more of its § 125 cafeteria plans to permit employees to apply unused amounts remaining in a health FSA or a dependent care assistance program as of the end of a grace period ending in 2020 or a plan year ending in 2020 to pay or reimburse expenses incurred for the same qualified benefit through December 31, 2020. For example, if an employer

sponsors a § 125 cafeteria plan with a health FSA that has a calendar year plan year and provides for a grace period ending on March 15 immediately following the end of each plan year, the employer may amend the plan to permit employees to apply unused amounts remaining in an employee's health FSA as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020.[3] This relief applies to all health FSAs, including limited purpose health FSAs compatible with HSAs. However, health FSA amounts may only be used for medical care expenses, and dependent care assistance program amounts may only be used for dependent care expenses. The extension of time for incurring claims is available both to § 125 cafeteria plans that have a grace period, and plans that provide for a carryover, notwithstanding Notice 2013-71, which otherwise continues in effect and provides that health FSAs can either adopt a grace period or provide for a carryover amount but cannot have both. The following examples illustrate how a plan with a July 1 plan year that allows a $500 carryover would implement the extended period for incurring claims allowed by this notice:

Example 1. Employer provides a health FSA under a § 125 cafeteria plan that allows a $500 carryover for the 2019 plan year (July 1, 2019 to June 30, 2020). Pursuant to this notice and Notice 2020-33, Employer amends the plan to adopt a $550 (indexed) carryover beginning with the 2020 plan year, and also amends the 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 respect to amounts from the 2019 plan year.

Employee A 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 was postponed. For the 2020 plan year beginning July 1, 2020, Employee A elects to contribute $2,000 to his health FSA. Employee A is able to reschedule the procedure before December 31,

[3] Certain plans would not need the relief provided in this notice. For example, a plan with a plan year ending on or after October 31, 2020, continues to be able to provide a grace period of up to two months and 15 days, which would allow the reimbursement of claims incurred after December 31, 2020.

2020 and, between July 1, 2020 and December 31, 2020, incurs $1,900 in medical care expenses. The health FSA may reimburse Employee A $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, Employee A is allowed to use the remaining $100 in his health FSA until June 30, 2021, to reimburse claims incurred during the 2020 plan year. Employee A may 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 medical care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee A may carry over to the 2021 plan year beginning July 1, 2021 up to $550 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.

Example 2. Same facts as Example 1, except that Employee B 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, Employee B elects to contribute $1,200 to his health FSA. Between July 1, 2020 and December 31, 2020, Employee B incurs $600 in medical care expenses. The health FSA may reimburse Employee B $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, Employee B is allowed to use $500[4] 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. Employee B 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 care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee B 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. A grace period is not available for the plan year ending June 30, 2021.

The extension of the period for incurring claims that may be reimbursed by the health FSA is an extension of coverage by a health plan that is not an HDHP for purposes of determining whether an eligible individual qualifies to make contributions to an HSA (except in the case of an HSA-compatible health FSA, such as a limited purpose health FSA). See section II.C. of this notice. Thus, an individual who had unused amounts remaining at the end of a plan year or grace period ending in 2020 and

[4] The maximum unused amount remaining in a health FSA from a plan year beginning in 2019 allowed to be carried over to the immediately following plan year beginning in 2020 is $500, whereas the maximum unused amount remaining in a health FSA from a plan year beginning in 2020 allowed to be carried over to the immediately following plan year beginning in 2021 is $550 (20 percent of $2,750, the indexed 2020 limit under § 125(i)). See Notice 2020-33.

who is allowed an extended period to incur expenses under a health FSA pursuant to a plan amended in accordance with this notice will not be eligible to contribute to an HSA during the extended period (except in the case of an HSA-compatible health FSA, including a health FSA that is amended to be HSA-compatible).

The relief set forth in this notice may be applied on or after January 1, 2020 and on or before December 31, 2020, provided that any elections made in accordance with this notice apply only on a prospective basis.

C. Plan Amendments

An employer that decides to amend one or more of its § 125 cafeteria plans to provide for mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs in a manner consistent with this notice or to provide for an extended period to apply unused amounts remaining in a health FSA or a dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses in a manner consistent with this notice must adopt a plan amendment. In addition, an employer that decides to amend its health FSA to provide for an increase in the carryover of unused amounts to the following year in a manner consistent with Notice 2020-33, for the 2020 plan year or plan years thereafter, must adopt a plan amendment.

An amendment for the 2020 plan year must be adopted on or before December 31, 2021, and may be effective retroactively to January 1, 2020, provided that the § 125 cafeteria plan operates in accordance with this notice or Notice 2020-33 or both, as applicable, and the employer informs all employees eligible to participate in

the § 125 cafeteria plan of the changes to the plan. Any amendment adopted pursuant to this notice must apply only to mid-year elections made during calendar year 2020, or to an extended period to apply unused health FSA amounts or dependent care assistance program amounts for the payment or reimbursement of medical care expenses or dependent care expenses incurred through December 31, 2020.

IV. MISCELLANEOUS

A. HDHPs and Application of Notice 2020-15

Notice 2020-15 provides that a health plan that otherwise satisfies the requirements to be an HDHP under § 223(c)(2)(A) will not fail to be an HDHP merely because the health plan provides medical care services and items purchased related to testing for and treatment of COVID-19 prior to the satisfaction of the applicable minimum deductible. This notice clarifies that the relief provided in Notice 2020-15 regarding HDHPs and expenses related to testing for and treatment of COVID-19 applies with respect to reimbursements of expenses incurred on or after January 1, 2020. This notice further clarifies that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) and any items or services required to be covered with zero cost sharing under section 6001 of the Families First Coronavirus Response Act (P.L. 116-127, 134 Stat. 178 (March 18, 2020)), as amended by the CARES Act, are part of testing and treatment for COVID-19 for purposes of Notice 2020-15.

B. HDHPs and Application of Section 3701 of the CARES Act

Section 3701 of the CARES Act amends § 223(c) of the Code to provide a temporary safe harbor for providing coverage for telehealth and other remote care services. As added by the CARES Act, § 223(c)(2)(E) of the Code allows HSA-eligible HDHPs to cover telehealth and other remote care services without a deductible or with a deductible below the minimum annual deductible otherwise required by § 223(c)(2)(A) of the Code. Section 3701 of the CARES Act also amends § 223(c)(1)(B)(ii) of the Code to include telehealth and other remote care services as categories of coverage that are disregarded for purposes of determining whether an individual who has other health plan coverage in addition to an HDHP is an eligible individual who may make tax-favored contributions to his or her HSA under § 223 of the Code. Thus, an otherwise eligible individual with coverage under an HDHP may also receive coverage for telehealth and other remote care services outside the HDHP and before satisfying the deductible of the HDHP and still contribute to an HSA. The amendments to § 223 of the Code under section 3701 of the CARES Act are effective March 27, 2020, and apply to plan years beginning on or before December 31, 2021. This notice provides that treatment of telehealth and other remote care services under section 3701 of the CARES Act applies with respect to services provided on or after January 1, 2020, with respect to plan years beginning on or before December 31, 2021. Therefore, for example, an otherwise eligible individual with coverage under an HDHP who also received coverage beginning February 15, 2020 for telehealth and other remote care services under an arrangement that is not an HDHP and before satisfying the deductible for the HDHP will not be disqualified from contributing to an HSA during 2020.

V. DRAFTING INFORMATION

The principal author of this notice is Jennifer Solomon of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), though other Treasury Department and IRS officials participated in its development. For further information on the provisions of this notice, contact Jennifer Solomon at (202) 317-5500 (not a toll-free number).

unused amounts (including amounts remaining in a health FSA) to pay expenses incurred for certain qualified benefits during the period of up to two months and 15 days immediately following the end of the plan year. See Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. § 1.125-1(e). This exception is based on other Code provisions and Treasury regulations that do not treat certain compensation arrangements as providing for deferred compensation if the compensation is paid no later than the fifteenth day of the third month after the taxable year in which the services are performed. See, e.g., Treas. Reg. § 1.404(b)-1T, Q&A-2.

Notice 2013-71 provided a further liberalization permitting a § 125 cafeteria plan to allow up to $500 of any unused amount in a participant's health FSA as of the end of a plan year to be paid or reimbursed to the participant for medical care expenses incurred in the immediately following plan year (the "permissive carryover" rule). In addition to the unused amounts of up to $500 that a plan may permit a participant to carry over to the next year, the plan may also permit the participant to elect up to the maximum amount of contributions through salary reduction permitted under § 125(i) for that year. Thus, under the liberalization provided through Notice 2013-17, the carryover of up to $500 does not count against, or otherwise affect, the indexed $2,500 limit on salary reduction contributions applicable to each plan year. Although the maximum unused amount allowed to be carried over in any plan year is $500, the plan may specify a lower amount as the permissible maximum carryover (and the plan sponsor has the option of not permitting any carryover at all).

Notice 2013-71, in permitting a carryover of $500, specified that a plan adopting a carryover provision is not permitted to also provide a grace period with respect to

health FSAs. Nor is the plan, for any plan year, permitted to allow a participant to elect a salary reduction contribution for health FSA benefits of more than the indexed $2,500 limit, or permitted to reimburse claims incurred during the plan year that exceed the applicable indexed $2,500 salary reduction contribution limit (and any nonelective employer contributions, often referred to as flex credits), plus the carryover amount of up to $500. If an employer adopts a carryover provision, the same carryover limit must apply to all plan participants. Also, a § 125 cafeteria plan is not permitted to allow unused amounts relating to a health FSA to be cashed out or converted to any other taxable or nontaxable benefit as this would result in deferral of compensation prohibited by § 125(a)(2)(A). Rather, unused amounts relating to a health FSA may be used only to pay or reimburse certain § 213(d) medical care expenses (excluding health insurance, long-term care services, or long-term care insurance). See Prop. Treas. Reg. § 1.125-1(q).

With respect to a participant, the amount that may be carried over to the following plan year is equal to the lesser of (1) any unused amounts from the immediately preceding plan year, or (2) $500 (or a lower amount specified in the plan). To prevent deferral of compensation, any unused amount in excess of $500 (or a lower amount specified in the plan) as of the end of the run-out period for the plan year is forfeited. Any unused amount in a participant's health FSA as of termination of employment also is forfeited (unless, if applicable, the participant elects COBRA continuation coverage with respect to the health FSA).

When Notice 2013-71 was issued, $500 represented 20 percent of the maximum allowed salary reduction amount under § 125(i). While the $2,500 maximum allowed

salary reduction amount is indexed for inflation under § 125(i)(2), Notice 2013-71 did not provide for any adjustment to the maximum $500 carryover amount. The indexed amount under § 125(i) for 2020 is $2,750.

On June 24, 2019, President Trump issued Executive Order 13877,[3] "Improving Price and Quality Transparency in American Healthcare to Put Patients First," which included an order that the Secretary of Treasury, to the extent consistent with law, issue guidance to increase the amount of funds that can carry over without penalty at the end of the year for flexible spending arrangements. In response to Executive Order 13877, the Treasury Department and the IRS are issuing this notice.

B. Timing of reimbursements by health plans

On October 12, 2017, President Trump issued Executive Order 13813,[4] "Promoting Healthcare Choice and Competition Across the United States," which included directions to the Secretaries of the Treasury, Labor, and Health and Human Services (the Departments) to "consider proposing regulations or revising guidance, to the extent permitted by law and supported by sound policy, to increase the usability of HRAs, to expand employers' ability to offer HRAs to their employees, and to allow HRAs to be used in conjunction with nongroup coverage." In response to Executive Order 13813, the Departments issued regulations allowing HRAs to be "integrated" with individual health insurance coverage or Medicare if certain conditions are satisfied.[5] These HRAs are referred to as individual coverage HRAs[6] and generally are designed

[3] 84 FR 30849 (June 24, 2019).
[4] 82 FR 48385 (Oct. 17, 2017).
[5] 84 FR 28888 (June 20, 2019).
[6] Treas. Reg. § 54.9802-4.

to reimburse employees for substantiated premiums for individual health insurance coverage and other medical care expenses.

Individual coverage HRAs are, nonetheless, employer-sponsored health plans and the exclusion from employees' gross income of reimbursements by these HRAs is subject to the requirements of §§ 105 and 106 and the underlying regulations. These requirements include the general rule that only payment or reimbursement for medical care expenses incurred by an employee during the plan year may be excluded from income and wages under §§ 105 and 106. Notwithstanding this general rule, as well as the rule prohibiting the deferral of compensation in a § 125 cafeteria plan, the Treasury Department and the IRS recognized certain practical difficulties and proposed a rule of administrative convenience that would permit amounts contributed by salary reduction from the last month of one plan year of a § 125 cafeteria plan to be applied to pay accident and health insurance premiums for insurance during the first month of the immediately following plan year, if done on a uniform and consistent basis with respect to all participants. See Prop. Treas. Reg. § 1.125-1(p)(5)(i) (upon which taxpayers may rely pending further guidance).

The restriction that a health plan may reimburse only medical care expenses incurred during the plan year raises analogous administrative issues in the case of an individual coverage HRA to the extent that a participant must pay, prior to the first day of a plan year, all or part of the premiums for individual health insurance coverage or Medicare during that plan year. Notice 2017-67, 2017-47 IRB 517, addresses these issues in the context of qualified small employer HRAs (QSEHRAs) under § 9831(d), which are arrangements similar to individual coverage HRAs. In particular, Q&A-52 of

Notice 2017-67 provides that, notwithstanding a general rule that a QSEHRA may not reimburse medical care expenses incurred before the eligible employee is provided the QSEHRA, a QSEHRA is permitted to treat a premium expense for a period of coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid.

III. GUIDANCE - FSA CARRYOVER AMOUNTS

A. Indexing of maximum carryover amount

As discussed in section II.A., this notice expands the exception to the prohibition on providing deferral of compensation through a § 125 cafeteria plan described in Notice 2013-71, which provides that a § 125 cafeteria plan may allow up to $500 of unused amounts in a participant's health FSA as of the end of a plan year to be carried over to pay or reimburse the participant for medical care expenses incurred in the immediately following plan year. Specifically, this notice increases the maximum $500 carryover amount for a plan year to an amount equal to 20 percent of the maximum salary reduction contribution under § 125(i) for that plan year. Because, by statute, the increase to the § 125(i) limit is rounded to the next lowest multiple of $50, increases to the maximum carryover amount, as the result of that indexing, will be in multiples of $10 (20 percent of any $50 increase to the § 125(i) limit). Thus, the maximum unused amount from a plan year starting in 2020 allowed to be carried over to the immediately following plan year beginning in 2021 is $550 (20 percent of $2,750, the indexed 2020 limit under § 125(i)).

B. Deadline for a written § 125 cafeteria plan amendment to implement indexing of maximum carryover amount for 2020 (or a later year)

As a general rule, an amendment to a § 125 cafeteria plan to increase the carryover limit must be adopted on or before the last day of the plan year from which amounts may be carried over and may be effective retroactively to the first day of that plan year, provided that the § 125 cafeteria plan operates in accordance with the guidance under this notice and informs all employees eligible to participate in the plan of the carryover provision. Because § 125(d)(1) provides that a § 125 cafeteria plan must be a written plan,[7] a § 125 cafeteria plan offering a health FSA may not utilize the increased carryover amount permitted under this notice for a plan year that begins in 2020 (or a later year) unless the plan is written in a manner that incorporates the increase by reference or the plan is timely amended to set forth the increased amount. Accordingly, a plan may be amended to adopt the increased carryover amount for a plan year that begins in 2021, for example, at any time on or before the last day of the plan year that begins in 2021; see section III.C. for a special amendment timing rule for the 2020 plan year. The ability to amend a plan to increase the carryover limit does not include the ability to allow employees to make new elections under the plan (but see relief for the 2020 plan year in section III.C.).

C. Extended period for employee elections for 2020

The final and proposed regulations under § 125 set forth a framework for the timing and amendments of participant elections that ensure the plan meets the requirements of the Code, including that the plan not provide for deferred compensation. Generally, under those regulations, an individual must make § 125 cafeteria plan elections before the start of the plan year, and those plan elections must

[7] See also Prop. Treas. Reg. § 1.125-1(c).

be irrevocable during the plan year, with limited exceptions that include certain changes in status to prevent the elections from constituting a deferral of compensation in contravention of § 125(d)(2)(A). See Treas. Reg. § 1.125-4 and Prop. Treas. Reg. § 1.125-2. As a result, an individual would be unable to modify his or her election for a health FSA on or after the first day of the 2020 plan year of the § 125 cafeteria plan, notwithstanding that the § 125 cafeteria plan is being amended to adopt the increased carryover amount for the 2020 plan year.

However, the Treasury Department and the IRS are simultaneously issuing a notice that, among other things, for the remainder of 2020, allows employers to permit mid-year elections under a § 125 cafeteria plan regarding a health FSA, including the ability to make an initial election to fund a health FSA, provided the changes are applied only prospectively. See Notice 2020-29, 2020-22 IRB __. Although Notice 2020-29 permits this flexibility temporarily in response to the public health emergency posed by the 2019 Novel Coronavirus, Notice 2020-29 does not limit the relief to individuals affected by the pandemic. Accordingly, individuals who, during 2020, wish to increase their health FSA contributions, or begin to make health FSA contributions, as a result of the increased carryover amount permitted under this notice may do so in accordance with Notice 2020-29. Although only future salary may be reduced under the revised election, amounts contributed to the health FSA after the revised election may be used for any medical care expense incurred during the first plan year that begins on or after January 1, 2020.

With respect to the requirement to amend the written plan, Notice 2020-29 provides that an amendment under this notice for the 2020 plan year must be adopted

on or before December 31, 2021, and may be effective retroactively to January 1, 2020, provided that the employer informs all individuals eligible to participate in the § 125 cafeteria plan of the changes to the plan.

IV. GUIDANCE - TIMING FOR REIMBURSEMENTS BY HEALTH PLANS

As discussed in section II.B. of this notice, a health plan, including a premium-reimbursement plan in a § 125 cafeteria plan or an individual coverage HRA, may not reimburse medical care expenses incurred before the beginning of the plan year and qualify for exclusion from income and wages under §§ 105 and 106. Medical care expenses are treated as incurred when the covered individual is provided the medical care that gives rise to the expense, and not when the amount is billed or paid. This notice provides that a plan is permitted to treat an expense for a premium for health insurance coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid. Thus, for example, an individual coverage HRA with a calendar year plan year may immediately reimburse a substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium for the coverage prior to the first day of the plan year.

V. EFFECT ON OTHER DOCUMENTS

Notice 2013-71 is modified to increase the annual maximum carryover amount allowed for a health FSA consistent with the guidance described above.

VI. INTENT TO REVISE EXISTING REGULATIONS; RELIANCE

The Treasury Department and the IRS intend to revise Prop. Treas. Reg. §§ 1.125-1(o) and 1.125-5(c) to reflect the guidance in this notice. Until the proposed

regulations are so revised, taxpayers may rely upon the guidance provided in this notice, which is favorable to taxpayers.

VII. DRAFTING INFORMATION

The principal author of this notice is Christopher Dellana of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Christopher Dellana at (202) 317-5500 (not a toll-free call).