YEAR-END 2020 LEGISLATIVE AND IRS DEVELOPMENTS FOR BENEFIT PLANS

By Felicia A. Finston, William M. Fisher, and Linda A. Wilkins
Wilkins Finston Friedman Law Group LLP
January 5, 2021

CONSOLIATED APPROPRIATIONS ACT CHANGES

The Consolidated Appropriations Act, 2021 (the "**Act**"), signed into law by President Trump on December 27, contains numerous provisions that impact employee benefit plans. Here is a summary of the most notable provisions.

Health and Dependent Care FSAs

Under the Act, health flexible spending arrangements ("**FSAs**") and dependent care FSAs may be amended (but are not required to be amended) to:

- Allow participants to carry over any unused balance from the plan year ending in 2020 to the plan year ending in 2021, as well as from the plan year ending in 2021 to the plan year ending in 2022. Note, the Act's relief expands upon more limited relief authorized by the IRS in Notice 2020-29, which allowed health FSAs (and not dependent care FSAs) to be amended to allow for a carryover of up to 20% of the annual maximum contribution election, which for 2020 meant a carryover limited to $550. For more information about the prior IRS relief, see our Client Alert at: http://www.wifilawgroup.com/clientalertmay152020.html;

- Provide an extended grace period of up to 12 months after the end of each of the plan years ending in 2020 and in 2021, as opposed to the traditional 2½ month grace periods allowed by statute. This also expands on the relief of IRS Notice 2020-29, which allowed for an extended grace period ending on December 31, 2020 for any plan year or grace period ending during 2020. However, it is still the case that an FSA may not have both a grace period and a carryover provision in effect during the same plan year. In other words, an FSA can either allow a carryover of unused amounts to the next plan year to be used for claims during that plan year or it can provide a grace period during which claims incurred during the first 2½ months of the next plan year may be reimbursed from the prior year's FSA balance; and

- Permit prospective mid-year election changes during the plan year that ends in 2021, without requiring a change in status event. This extends by one year the relief previously offered by IRS Notice 2020-29.

Furthermore, a health FSA may be amended to allow employees who terminate employment in 2020 or 2021 to continue receiving reimbursements from unused benefits and contributions for expenses incurred through the end of the year (plus any applicable grace period) in which they were terminated without running afoul of the risk sharing requirements applicable to health FSAs. It is unclear from the statute exactly how this rule works; i.e. whether the reimbursements can only be made from the participant's remaining contributions that have already been made to the health FSA via salary reduction or from the unused annual election amount, which must be uniformly available at any time under existing rules. If the rule applies to the unused annual election amount, it would eliminate the need to offer COBRA coverage for those health FSA participants who terminate with a positive balance, and would mean the employer would be responsible for funding those reimbursements that exceed the participant's

account balance but are less than the participant's annual election amount. If that is the proper interpretation, it is unlikely that many employers would adopt this optional amendment because the financial burden would fall on them alone. Further IRS guidance on this matter would be helpful.

Finally, a dependent care FSA may be amended to allow targeted relief to employees who have a dependent reach age 13 during the COVID pandemic, effectively allowing a carryover of an unused balance that may be used to reimburse dependent care expenses incurred up to age 14 to be reimbursed.

Takeaway: Plan sponsors should determine whether they wish to implement all or a portion of this optional relief under the Act. If so, they should communicate the chosen relief to plan participants and make sure to operate the plans consistent with such relief. Retroactive plan amendments to implement the chosen relief must generally be adopted by December 31, 2021, although different deadlines may apply to fiscal year plans. When drafting such amendments, care must be taken to properly reflect the terms of any of the more limited relief that may have been implemented during 2020 pursuant to IRS Notice 2020-29, which has the same amendment deadline. If adopting any of the relief offered by the Act, plan sponsors should consider taking steps to limit their financial exposure, including limiting the number of mid-year election changes that will be permitted and prohibiting reductions in pre-tax FSA elections or carryovers of unused contributions or balances that would result in underfunding of reimbursements that have already been made.

Tax Exclusion for Student Loan Debt Paid by Employers

The Act provides that, if an employer pays any student loan debt on behalf of its employees, these payments will be non-taxable as educational assistance program "fringe benefits." The maximum annual exclusion for all educational assistance programs is $5,250. This rule applies to payments made between March 27, 2020 and December 31, 2025.

Relaxation of Partial Termination Rules

Plan sponsors have been justly concerned that the number of lay offs made on account of the pandemic may have triggered a partial termination of their qualified plans in 2020, which would require full vesting of the affected participants. However, the Act relaxes the partial termination rules by extending the period used to determine whether such a termination has occurred, in effect allowing new hires/rehires who become covered by a plan by March 31, 2021 to be taken into account to offset terminated participants. Specifically, no partial termination will occur during any plan year which includes the period beginning on March 13, 2020 and ending on March 31, 2021 if the number of active participants covered by the plan on March 31, 2021 is at least 80% of the number of active participants covered on March 13, 2020.

NEW IRS GUIDANCE

Clarifications to SECURE Act Provisions re Long-Term Part-Time Employees

The Internal Revenue Service has issued new guidance addressing the impact of the pandemic on employee benefit plans and reviewing SECURE Act requirements. Here is a summary:

IRS Notice 2020-68 (at https://www.irs.gov/pub/irs-drop/n-20-68.pdf) provides guidance on implementing the new 401(k) plan eligibility rules that require certain long-term part-time employees ("**LTPTEs**") to be allowed to make elective deferrals, even if they do not complete a traditional service requirement of 1000 hours of service in a year. Under the SECURE Act, an employee who completes at least 500 hours of service in three consecutive 12-month periods, starting with plan years beginning after December 31, 2020, cannot be excluded from the plan based solely on failure to complete 1,000 hours of service in a year. So long as the employee is age 21 and not in another excluded class of employees, the employee must be permitted to make elective deferrals once they have completed at least three consecutive years with at least 500 hours of service, which at the earliest will be the first plan year beginning after December 31, 2023. See our Client Alert regarding the SECURE Act at: http://www.wifilawgroup.com/clientalertjanuary142020.html.

Takeaway: Plan sponsors must begin to track hours worked by LTPTEs for plan years beginning in 2021 and retain that information in future years so they can determine whether plan eligibility is met under this provision for any plan years starting after December 31, 2023. Also, plan sponsors must amend their plans to comply with this, as well as other SECURE and CARES Act requirements, by the last day of the first plan year beginning on or after January 1, 2022 (2024 for governmental plans).

The SECURE Act does not require plans to provide employer contributions, such as matching contributions, to LTPTEs who meet the service requirement and must be allowed to make elective deferrals. However, if an employer chooses to amend its 401(k) plan and provide employer contributions to LTPTEs, it may incur an unexpected recordkeeping burden. The Notice clarifies that years of service for purposes of vesting in any employer contributions made to LTPTEs must include all years in which the employee was at least age 18 and completed at least 500 hours of service. This differs from the rules for determining eligibility of LTPTEs to make elective deferrals in three ways: for vesting purposes, there must be taken into account years before 2021, years between ages 18 and 21, and nonconsecutive years.

Takeaway: Plan sponsors should be aware that they will be inviting a potentially significant recordkeeping burden if they decide to amend their 401(k) plans to provide employer contributions to LTPTEs and subject those contributions to a vesting schedule. Before making this choice, employers should visit with their third-party recordkeepers concerning the feasibility of collecting and maintaining the information needed to track vesting, including for periods of service before 2021 for which the plan sponsor (understandably) may not have been tracking/retaining such information.

Extended Permission for Remote Notarization

Under IRS Notice 2021-3, remote notarization of spousal consent forms will continue to be permitted through June 30, 2021. This is an extension of the relief from the physical presence requirement originally included in IRS Notice 2020-42 and described in our Client Alert at http://www.wifilawgroup.com/clientalertjune32020.html.