

FSA Plan Administration During a Time of Crisis

A recession or other economic crisis can cause employers and employees to take actions to reduce expenses, conserve funds, and restructure their operations. Some of these actions have implications for cafeteria plans and their component benefits.

1. Election Change Issues

During a recession, employees may want to change their cafeteria plan elections for personal economic reasons, or in response to actions taken by the employer. However, midyear election changes can only be allowed when there is an event recognized under IRS regulations as permitting a change in election. In addition, the requested election change must be consistent with the event and must be permitted under the terms of both the cafeteria plan and the insurance policy or other document governing the component benefit to which the request relates. Events likely to occur in a recession that may trigger midyear election change requests include the following:

- a furlough or other reduction in hours of an employee's employment;
- a reduction in an employee's pay (i.e., due to an across-the-board pay cut or the employee's loss of a second job);
- a termination or reduction in hours of family member's employment, or a reduction in a family member's pay;
- a change in tax-dependent status of an employee's child, parent, or other relative (i.e., an unemployed son or daughter may become a tax dependent of the employee);
- a change in the cost or design of a plan maintained by the employer or by a family member's employer; and
- the termination of a plan maintained by the employer or by a family member's employer.

**Note that a reduction in a participant's or family's income, standing alone, is not a permitted election change event, although it might occur in connection with another event that might permit a midyear election change.*

2. Termination of Employment

Workforce reductions and other employment terminations may occur more frequently during a recession, and may raise cafeteria plan issues such as the following:

- whether the employer's health FSA qualifies for the special limited COBRA obligation and other COBRA administration issues that can arise under health FSAs;
- whether severance can be used to pay for COBRA coverage or other benefits through the cafeteria plan;
- the extent to which terminated employees can access underspent FSAs or DCAPs to pay for expenses incurred after participation terminates;
- issues arising from the uniform coverage rule for health FSAs, including the extent to which the employer's risk of loss (overspent accounts) under health FSA can be minimized; and

- issues arising from the use-or-lose rule, including how to deal with experience gains arising from participant forfeitures or attempts to use up health FSA benefits before termination through "stockpiling".

Employers should be advised that there is a "safe harbor" in place for employees that are rehired. Because termination/rehire situations with an unemployment period of 30 days or less may be closely scrutinized by the IRS, administrators should typically follow the "step back into" rule when these situations occur. Under this approach, (1) the maximum annual FSA benefit would not decrease during a leave of less than 30 days where coverage continues; (2) expenses incurred during the period of noncoverage would not be eligible; and (3) the employer would be prohibited from "catching up" salary reductions upon the employee's return. Generally the "step back into" method follows the reinstatement of major medical coverage, but if an employer would like the FSA provisions to be different, an amendment may need to be made to their document. When more than 30 days have elapsed between an employee's termination and rehire, the plan (by design) can either allow a new election, require that the old election be reinstated, or keep the participant out of the plan until the next year.

[IRS Notice 2014-55](#) details additional permitted election changes. Under Treas. Reg. § 1.125-4(c)(2)(iii), an election change is only allowed if eligibility for the underlying benefit or cafeteria plan is affected upon a "commencement of or return from an unpaid leave of absence".

This is intended to provide general guidance of how times of crisis are currently viewed by the IRS. We will provide further guidance as it is made available. If you are concerned about a specific circumstance, we recommend contacting an ERISA and/or Employee Benefits Attorney for legal advice.