

Flexible Spending Account Relief in Consolidated Appropriations Act, 2021

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In December, the President signed the Consolidated Appropriations Act, 2021 (CAA), which combines COVID-19 stimulus relief with a number of year-end appropriations bills. The CAA contains numerous provisions that will impact health and welfare plans. The provisions of the CAA that need immediate attention are the temporary special rules for Health Care Flexible Spending Accounts (“Health FSAs”) and Dependent Care Flexible Spending Accounts (“Dependent Care FSAs”), together referred to as FSAs. The main crux of these FSA provisions is to alleviate the impact of the FSA use-it-or-lose-it rules and to provide additional flexibility with regard to mid-year FSA elections.

Each of these FSA provisions is permissive — a company is not required to adopt any of these provisions. However, if a company does decide to amend for these FSA provisions, it will first need to confirm with its FSA third-party administrator (TPA) that the TPA can administer these new FSA provisions before communicating these provisions to its employees. For any FSA changes, notification must be provided to eligible employees; however, the CAA allows additional time for companies to adopt formal plan amendments.

Carryover Provisions Expanded

A company can amend its limited purpose Health FSA, general purpose Health FSA and/or Dependent Care FSA to allow participants to carry over ALL unused amounts from the 2020 plan year to the 2021 plan year. Note: A company also can amend its FSAs to allow participants to carry over all unused amounts from the 2021 plan year into the 2022 plan year.



- The current Internal Revenue Code (“Code”) Section 125 rules provide that a Health FSA may allow carryover of unused balances of up to \$550 (indexed) remaining at the end of a plan year, to be used for qualified medical expenses incurred in a subsequent plan year. The CAA FSA provisions temporarily remove this cap. For example, assume that a participant in a calendar year Health FSA had \$900 left in his Health FSA as of December 31, 2020. That \$900 can be carried over into 2021 plan year. The carryover amount will not decrease the maximum salary contribution amount that the participant can make for the 2021 plan year (i.e., the participant can still elect to contribute the maximum amount of \$2,750).
- For a company that offers a high deductible health plan (HDHP), the company will need to decide how it will design this carryover feature so that it does not impact an employee’s eligibility to contribute to a Health Savings Account (HSA). Note: A carryover to a general purpose Health FSA will make the participant ineligible to contribute to their HSA for the entire subsequent plan year (even after the carryover is exhausted). We believe that a reasonable Health FSA design could allow the carryover to be automatically converted to a limited purpose Health FSA if the participant enrolls in an HDHP or by allowing participants to irrevocably decline the carryover. Carryover designs of this type will allow a participant to maintain HSA eligibility.
- The carryover provision must be offered to all eligible employees in the FSA and not just select groups of participants covered under the plan.
- Current guidance provides that Health FSA carryovers can be limited to individuals who have elected to participate in the employer’s Health FSA in the next plan year. This plan design is permitted even if a minimum salary reduction is required for participation. However, if a company decides to newly add the FSA carryover feature in response to the CAA guidance, it may consider not including this requirement (or allow its employees who had previously waived 2021 FSA coverage to make a mid-year election to add FSA coverage for the 2021 plan year).
- Prior to the CAA, carryovers were not permitted for Dependent Care FSAs. Under the CAA, a Dependent Care FSA may be amended to temporarily include a carryover. While it is not clear from the CAA, the carryover probably does not count towards the annual maximum contribution limit for a Dependent Care FSA. IRS guidance on this issue would be helpful.

Grace Period Extended

Rather than having an FSA carryover, a company may provide a 12-month grace period at the end of the 2020 plan year during which all unused 2020 plan year FSA amounts will be available for claims incurred during the subsequent 12 months. This extended 12-month grace period is also available for unused FSA amounts at the end of the 2021 plan year.

Under the current Code Section 125 rules, a cafeteria plan may allow participants to access unused amounts after the end of a plan year to pay or reimburse expenses for qualified benefits incurred during a “grace period” of up to two months and 15 days after the close of the plan year.

The CAA extends this “two months and 15-day” grace period to 12 months. Note: It is not clear if an FSA can elect a grace period shorter than 12 months, such as a 6-month grace period.

- Example: Assume that a participant participates in a calendar-year FSA that has adopted the extended 12-month grace period. The participant has \$1,000 remaining unused in their FSA at the end of the 2020 plan year. The participant can be reimbursed for eligible expenses incurred from 1/1/2021 through 12/31/2021 from their 2020 plan year FSA balance of \$1,000.
- The grace period provision does not work well in a general purpose Health FSA if a company wishes to facilitate employees’ eligibility to contribute to an HSA. An employee who is covered by a general purpose Health FSA and is entitled to a grace period will be ineligible to make or receive HSA contributions for the duration of the grace period. Further, under current guidance, participants cannot waive the grace period, and the grace period must apply uniformly to all participants. However, we believe that a general purpose Health FSA can have a plan design in which the grace period automatically converts to an HSA-compatible FSA during the grace period, but that such a design must be applicable to all employees in the Health FSA (even those not enrolled in an HDHP).
- An FSA cannot have both the carryover provision and the grace period — it can have one or the other.

Spend Down Newly Available for Health FSAs

A Health FSA can permit participants who terminate employment mid-year to continue to incur claims for the remainder of the plan year (including any grace period). This would be permitted for 2020 and 2021.

- A spend down provision for a general use Health FSA would make an individual ineligible to make or receive HSA contributions. While it is not clear, it appears that an individual could decline this spend down coverage.
- Existing IRS rules already permit a spend down feature for Dependent Care FSAs. Accordingly, Dependent Care FSA spend downs were not addressed in the CAA.

Additional FSA Election Change Relief

For 2021, a company can amend its FSAs to allow participants in the FSAs to make election changes mid-year — without having a qualified change in status event. It is not clear, but it appears that FSAs can be amended to permit employees who have not elected to make FSA contributions for 2021 to make new elections to contribute mid-year.

- Elections can only be made on a prospective basis.
- This election change opportunity only applies to FSAs. Unlike prior IRS relief, this mid-year election change opportunity does not apply to medical, dental, and/or vision elections.
- Prior to allowing such mid-year elections, a company will need to understand if its FSA TPA can support these changes and the associated cost.

Amendment to Definition of “Child” for the Dependent FSA

The CAA increases the maximum age of a dependent child for purposes of eligible dependent care expenses to age 14, from age 13, but with some limitations. For a qualifying child who turned age 13 during the last plan year, the Dependent FSA can be amended to allow reimbursement of expenses related to such child’s dependent care for the remainder of the plan year (if the enrollment period ended before January 31, 2020).

- For example, for a calendar-year plan, the rule applies to a Dependent Care FSA participant who was enrolled in the plan in 2020 and who had a dependent child who turned age 13 during 2020.
- In addition, if the Dependent FSA has adopted the carryover feature, this rule will allow for the reimbursement of expenses for dependent care provided to such child in the following plan year until the child turns age 14, but only with respect to unused amounts carried over from 2020 into 2021.

Plan Amendments

If a company wants to make any of these permitted changes to its FSAs, it must amend the FSAs no later than the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective, e.g., no later than December 31, 2021 for an amendment that provides for a carryover of 2020 amounts from a calendar year FSA.

Action Items

A company should consider taking the following action steps related to the FSA CAA provisions:

- Discuss whether the company’s FSAs should be amended for any of the permissive provisions described above;
- For any plan changes being considered, the company should discuss with its FSA TPA if it is able to implement the changes — and the costs associated with those changes;
- Develop and distribute communications to employees about the FSA plan changes; and
- Draft and adopt FSA plan amendments.

Additional Guidance

We believe that the IRS will issue additional guidance on these rules. We will update this article in the event such guidance is issued.

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