



Flexible Spending Accounts—IRS Guidance on Permissive Changes

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Date: March 4, 2021

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Consolidated Appropriations Act, 2021

- ★ The Consolidated Appropriations Act, 2021 (CAA) was signed by the President on December 27, 2020
- ★ It contained special, temporary provisions regarding Health Flexible Spending Accounts (“Health FSAs”) and Dependent Care Flexible Spending Accounts (“DC FSAs”) (together referred to as “FSAs”)
- ★ On February 18, 2021, the IRS issued Notice 2021-15 (the “Notice”), which provided additional guidance on the FSA provisions in the CAA and included additional relief

CAA — Flexible Spending Account Provisions

- ✦ These are temporary special rules for the FSAs
- ✦ Each of these FSA provisions are permissive — a company is not required to adopt any of these provisions
- ✦ 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 and the Notice allow additional time for companies to adopt formal plan amendments

IRS Notice 2021-15 – Overview

- ✦ For Health Plans – Allows mid-year elections for health plans for plan years ending in 2021 for health, dental, and/or vision plans
- ✦ For FSAs
 - > Allows for unlimited carryovers of unused amounts from plan years that end in 2020 and 2021
 - > Extends the permissible period for incurring claims for plan years that end in 2020 and 2021
 - > Allows for mid-year election changes for plan years ending in 2021
 - > Allows for spend downs/extended claims period for Health FSAs during 2020 and 2021 (this was already permitted for DC FSAs)
- ✦ Only For DC FSAs
 - > Allows for a special claims period and carryover rule for DC FSAs when a dependent “ages out” during the COVID-19 public health emergency

IRS Notice 2021-15—Health Plan Elections

- ✦ According to the Notice, a company can amend the health plan (major medical, dental, or vision) to allow for the following changes for the plan year ending in 2021:
 - > make a new election on a prospective basis, if the employee initially declined to elect health coverage;
 - > revoke an existing election and make a new election to enroll in different health coverage sponsored by the company on a prospective basis (such as moving from the HMO to a PPO or changing enrollment from single-only coverage to family coverage); and
 - > 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 company (such as an Exchange plan)

Health Plan Elections

- ✦ Note that coverage cannot be dropped unless the employee is revoking his/her election in order to enroll in a similar plan offered by the company or a plan offered by another entity
- ✦ If the employee is revoking company-sponsored health coverage and is not enrolling in different company-sponsored health coverage, the employer must receive an employee attestation in writing that states he/she is enrolled, or immediately will enroll, in other comprehensive coverage not sponsored by the employer
- ✦ The Notice includes a template document that can be used as the attestation

Health Plan Elections

- ★ The Notice states, “An employee revoking an existing election for comprehensive health coverage may not revoke the election by attesting to enrollment in coverage solely for dental or vision benefits.”
- ★ A company can restrict the time period for the elections and what election changes can be made (such as a person could only elect into coverage or increase coverage—such as from single-coverage to family-coverage)

FSA Elections

- ✦ A company can amend the FSAs to allow for the following changes for the plan year ending in 2021:
 - > revoke an election, make one or more elections, or increase or decrease an existing election, for plan years ending in 2021 regarding a Health FSA, or
 - > revoke an election, make one or more elections, or increase or decrease an existing election, for plan years ending in 2021 regarding a DC FSA
- ✦ Prospective election changes may include an initial election into the FSAs
- ✦ The company can limit the time period during which election changes may be made

FSA Elections

- ✦ A company can amend the Health FSA for the 2021 and 2022 plan years to make mid-year elections to change between a general purpose Health FSA and a limited purpose Health FSA
 - > This is an important tool that can be used preserve Health Savings Account (“HSA”) eligibility status
 - For HSA eligibility status, the employee must be covered under a high deductible health plan (“HDHP”) and not have other disqualifying coverage
- ✦ Any election to decrease contributions can be limited to amounts no less than amounts already reimbursed

FSA Elections

- ✦ Although revised elections may be applied only prospectively, the company may allow amounts contributed to the Health FSA or DC FSA after the revised election to be used for any medical care expense or dependent care expense, respectively, incurred on or after January 1, 2021 through the end of the plan year ending in 2021
- ✦ This relief extends to expenses incurred by employees who were not enrolled in the Health FSA or DC FSA on January 1, 2021. (For example, if the employee enrolled on March 1, 2021 in the Health FSA, that coverage could be used for claims incurred in January of 2021.)

FSA Elections

- ✦ If an FSA election is revoked, the treatment of previously contributed amounts are subject to the terms of the plan, which must apply uniformly to all participants
- ✦ The plan may provide that the amounts contributed before the election is revoked:
 - > remain available for the rest of the plan year; or
 - > will only be available to reimburse eligible expenses incurred before the revocation takes effect; or
 - > will be forfeited

FSA Elections

- ✦ For a Health FSA, if the plan provides that revocation of an election terminates participation in the Health FSA, and that no subsequent reimbursements will be available following the revocation, the Health FSA will no longer be treated as health coverage that disqualifies an otherwise eligible individual from contributing to an HSA
- ✦ Similarly, if under the terms of the plan, the Health FSA reimburses only expenses incurred before the date of revocation—then following the revocation, the Health FSA will not be treated as health coverage that disqualifies an otherwise eligible individual from contributing to an HSA for the months after the date of revocation

FSA Elections

- ✦ Example #1. During the enrollment period for the 2021 calendar plan year, employee elects to contribute \$1,200 to a health FSA for the year. The plan allows the employee to revoke or change the election by March 1, 2021. The employee makes a prospective election to revoke the election effective March 1, at which time the employee has contributed \$200 to the health FSA. Under the terms of the plan, amounts contributed before the revocation of the election remain available to reimburse medical care expenses incurred for the rest of the plan year. Consequently, the employee has coverage by the health FSA for 2021 and will not be eligible to contribute to an HSA for calendar year 2021 even if otherwise eligible (that is, covered by an HDHP), unless the plan allows the employee to opt out of this extended period for incurring claims, and the employee opts out of this period

FSA Elections

- ★ Example #2. During the regular enrollment period for the 2021 calendar plan year, employee elects to contribute \$1,200 to a health FSA for the year. The plan allows the employee to revoke or change the election by March 1, 2021. The employee makes a prospective election to revoke the election effective March 1, at which time the employee has contributed \$200 to the health FSA. Under the terms of the plan, revocation of the election means that the employee may use the \$200 that was contributed to the health FSA prior to March 1 to reimburse only medical care expenses incurred prior to March 1.
- ★ The Health FSA coverage during January and February will not make the employee ineligible to contribute to an HSA during the rest of the plan year (i.e., March 1, 2021 to December 31, 2021) if otherwise eligible.

FSA Elections

- ✦ An employer can amend an Internal Revenue Code (“Code”) § 125 plan to allow an employee to make a mid-year election to be covered by a general purpose FSA for part of the year and an HSA-compatible Health FSA for part of the year
- ✦ In addition, plans can be amended to offer employees a choice between an HSA-compatible Health FSA or general purpose FSA during the plan year in which there is a carryover or extended period to incur claims, on an employee-by-employee basis
- ✦ This is important for preserving HSA eligibility, if desired
 - Eligibility to contribute to an HSA is determined on a month-by-month basis.

FSA — Carryover Provision

- ★ The current Code § 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 plan years that end in 2020 and 2021

FSA — Carryover Provision

- ★ Example: If an employer sponsored a calendar year § 125 cafeteria plan in 2020 with a health FSA that provides for a \$550 carryover, the employer may amend the plan to permit a participant to carry over the entire unused amount remaining in an employee's health FSA amounts as of December 31, 2020, to the 2021 plan year (even if that amount exceeds \$550). The employer also may amend the plan to carry over the entire unused amount remaining in an employee's health FSA as of December 31, 2021, to the 2022 plan year
- ★ This relief applies to all health FSAs, including HSA-compatible health FSAs, and also applies to all DC FSAs

FSA — Carryover Provision

- ✦ 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
- ✦ The DC FSA can be amended to include a carryover
- ✦ The carryover can be added regardless of whether the FSA previously offered the carryover
 - > For example, the DC FSA could add a carryover for 2020, even though the 2020 plan year is over
- ✦ The carryover will not count towards the annual maximum contribution limit for an FSA

FSA — Carryover Provision

- ✦ An employer can limit the carryover to an amount less than all unused amounts and may limit the carryover to apply only up to a specified date
- ✦ Remember that a carryover to a general purpose Health FSA will make the participant ineligible to contribute to an HSA for the entire subsequent plan year
- ✦ A Health FSA design could include the carryover being automatically converted to a limited purpose Health FSA if the participant enrolls in an HDHP or allowing participants to irrevocably decline the carryover
- ✦ As stated in a previous slide, § 125 cafeteria plan can allow a participant to elect to change between a general purpose Health FSA and an HSA-compatible Health FSA

DC FSA — Carryover Provision

- ✦ Amounts contributed to a DC FSA are required to be reported in Box 10 of Form W-2. Employers may report in Box 10 for a year the salary reduction amount elected by the employee for the year for the DC FSA and are not required to adjust the amount reported in Box 10 to take into account amounts that remain available in a grace period
- ✦ Amounts that are carried over or available under the extended grace period provided by the CAA and Notice will not have to be reflected in Box 10 of the Form W-2
 - > Any amount carried forward from 2019 and used in 2020 is treated as an amount that remains available in a grace period

FSA — Carryover Provision

- ✦ With respect to Form 2441, “Child and Dependent Care Expenses,” any amounts carried forward from 2019 are similarly treated as amounts carried over and used during the grace period
- ✦ Similar rules should apply for 2021 and 2022
- ✦ Informally, the IRS has confirmed that it intends to amend Form 2441 so that amounts carried forward under Section 214 of the CAA are not taxable

FSA — Grace Period

- ✦ Instead of having an FSA carryover, a company may provide a 12-month grace period at the end of the plan year that ends in 2020, so that all unused FSA amounts as of the end of such plan year will be available for claims incurred during the subsequent 12 months
 - > An FSA cannot have both the carryover provision and the grace period — it can have one or the other
- ✦ This extended 12-month grace period is also available for unused FSA amounts at the end of the 2021 plan year
- ✦ In addition, amounts available on the last day of a plan year due to a 12-month grace period are not required to be forfeited but can be available for the next grace period

FSA — Grace Period

- ★ Calendar Plan Year Example. Assume that a participant participates in a calendar year FSA that has adopted the extended 12-month grace period. The participant has \$2,000 remaining unused in their FSA at the end of the 2020 plan year. For the 2021 plan year, the participant elects to contribute \$2,000 to the FSA. Between 1/1/21 and 12/31/21, the participant incurs \$3,300 in eligible expenses. The FSA may reimburse the participant \$3,300, leaving \$700 in the health FSA as of 12/31/21

FSA — Grace Period

- ★ Non-Calendar Plan Year Example. Assume that a participant participates in a non-calendar year FSA (July 1 to June 30) that has adopted the extended 12-month grace period for the plan year ending 6/30/21, allowing claims incurred on or after 7/1/21, but prior to 7/1/22, to be paid from amounts for the plan year ending 6/30/21
- ★ The participant elects to contribute \$1,800 for the plan year ending 6/30/21 and as of the end of such plan year has a balance of \$1,800 in the FSA. The participant elects to contribute \$1,000 to the FSA for the plan year ending 6/30/22. Between 7/1/21 and 6/30/22, the participant incurs \$2,000 in eligible expenses. The FSA may reimburse the participant \$2,000, leaving \$800 in the FSA as of 6/30/22

FSA — Grace Period

- ✦ 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. Under the pre-CAA guidance, participants could not waive the grace period and the grace period must apply uniformly to all participants
- ✦ However, IRS Notice 2021-15 changes this rule
 - > Participants may be offered the ability to opt-out of the grace period on a participant-by-participant basis
 - > The Health FSA could have a plan design for all employees enrolled in the HDHP, which automatically converts the amounts subject to the grace period to a limited purpose Health FSA
- ✦ A company could amend one plan (such as the DC FSA) to have the grace period and the other plan (Health FSA) to have the carryover, if it wanted that design

FSA — Extended Claims Period or Spend Down

- ✦ A Health FSA can permit participants who terminate employment mid-year to continue to incur claims for the remainder of the year (including any grace period)
- ✦ This would be permitted for individuals who remain eligible to incur claims but have ceased participation in the Health FSA as a result of termination of employment, change in employment status, or new election during calendar year 2020 or 2021
- ✦ Existing IRS rules already permit a spend down feature for DC FSAs. Accordingly, DC FSA spend downs were not addressed in the CAA

FSA — Spend Down

- ✦ This spend down feature is limited to the end of the plan year in which participation ceased (including any grace period, if applicable)
- ✦ For the Health FSA, the time period to spend down amounts may be limited and does not need to extend to the end of the year
- ✦ For the Health FSA, the spend down amount can be limited to the amount contributed to the plan—rather than the full elected amount. (If the terminated employee wants access to the full Health FSA elected amount, he/she can elect COBRA.)
- ✦ The plan can allow a participant to opt-out of the spend down feature (to preserve HSA eligibility)
- ✦ The spend down feature can be applied to a plan with a carryover or a grace period—or even a plan that has neither of those features

Grace Period vs Carryover

- ✦ The two are very similar under the CAA, except that they interact differently with respect to the spend down feature
- ✦ A plan with a grace period can also allow employees who have ceased participation in the plan earlier in the year to further extend a period for including claims until the end of the next plan year
- ✦ For example, Josh terminates on May 1, 2021. Under the spend down feature, Josh could continue to incur claims for any remaining amounts in his FSA until December of 2022—this is because the spend down rule allows for the extended claims period to continue for the remainder of the year PLUS any applicable grace period
- ✦ The time period to incur claims would be shorter for Josh if he was in a plan with a carryover because the extended claims period would terminate at the end of 2021 (the year in which he terminated)

Grace Period vs Carryover

- ★ For a plan that has a grace period for the 2022 plan year, all unused amounts at the end of 2022 could be used for claims incurred prior to March 15, 2023
- ★ For a plan that has a carryover at the end of 2022, the carryover amount to the 2023 plan year would be limited to \$550. (Note that a Health FSA can have a carryover from the 2022 to the 2023 plan year—but NOT the DC FSA.)

Dependent Care FSA — Definition of Child

- ★ 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
- ★ In no event does the CAA provision permit an employer to reimburse expenses for a child who is age 14 years or older

Dependent Care FSA — Definition of Child

- ✦ The provision applies only to employees who enrolled in a DC FSA for which the regular open enrollment period for such plan year was on or before January 31, 2020 (the “2020 Plan Year”)
- ✦ Such employee must have one or more children who attained age 13 either during the 2020 Plan Year, or in the plan year immediately following (the “2021 Plan Year”) — but the 2021 Plan Year amounts that can be used for such child can only be the unused amounts carried forward from the 2020 Plan Year
- ✦ Note that the DC FSA does not need to adopt the carryover or the extended grace period for this extended claim provision to apply—it is a separate provision just for this rule
- ✦ The DC FSA plan document and benefit summary will need to be clear on this issue

Dependent Care FSA—Definition of Child

- ✦ Example 1: Employer provides a DC FSA with a non-calendar plan year. The regular open enrollment period for the 2020 plan year (3/1/20-2/28/21) ended on January 31, 2020. Employee elected to enroll DC FSA for the 2020 plan year, electing to contribute \$5,000. Employee's Dependent turns age 13 on 2/1/21
- ✦ As of 1/31/21, Employee has incurred no qualifying expenses for the 2020 plan year. However, Employee anticipates incurring dependent care expenses during the summer of 2021, which is during the 2021 plan year (3/1/21-2/28/22)
- ✦ Employer amends the DC FSA by substituting "under age 14" for "under age 13" for the 2020 and 2021 plan years. Employer allows employees until the end of the next plan year to incur claims (but does not adopt the extended grace period or carryover provisions)
- ✦ Employee incurs \$5,000 in February 2021 for the 13-year-old dependent. The \$5,000 may be reimbursed by the DC FSA for the 2020 plan year

Dependent Care FSA—Definition of Child

- ★ Example 2: Similar facts to the prior example. Here, Employee contributed \$4,000 to the DC FSA in the 2020 plan year (3/1/20-2/28/21) and elects to contribute \$500 for the 2021 plan year (3/1/21-2/28/22). As of the end of the 2020 plan year, the Employee incurred no qualifying expenses. Employee incurs \$4,200 in eligible expenses from June through August 2021 for dependent, who turned age 13 on 2/1/21
- ★ For the 2021 plan year, \$4,000 of the \$4,200 in eligible expenses may be reimbursed. (\$4,000 is the unused amount from the 2020 plan year that may be applied to reimburse eligible expenses during the subsequent plan year for a dependent who attained age 13 during the preceding plan year, until that dependent attains age 14, so the remaining \$200 in dependent care expenses for the dependent may not be reimbursed.)
- ★ Employee does not incur any other eligible expenses during the 2021 plan year. The \$500 remaining in the DC FSA as of 2/28/22, is forfeited

Interaction With COBRA

- ✦ In certain circumstances, Code § 4980B permits qualified beneficiaries (“QBs”) who lose coverage under a group health plan, including under a Health FSA, to elect continuation health coverage under COBRA (“COBRA Continuation Coverage”)
- ✦ The Notice states that an individual is otherwise a QB with respect to coverage by a health FSA, a limited extension of coverage (such as the spend down) will not prevent the individual from having a loss of coverage resulting in a qualifying event (for example, by termination of employment or reduction in hours of a covered employee), and the relevant employer will be required to provide a notice of the right to elect COBRA Continuation Coverage to the individual

Interaction With COBRA

- ✦ For example, if an employer allows an employee who ceases to be a participant as the result of termination of employment to be reimbursed for expenses incurred after the termination through access to the amount of salary reduction contributions that have been made as of the date the employee ceased being a participant, this event would constitute a COBRA qualifying event subject to notice requirements
- ✦ As a further example, if an employee elected to contribute \$2,400 to a Health FSA, terminated employment on January 31 after making \$200 in salary reduction contributions, and as a result of the termination was no longer permitted to contribute to the health FSA other than by electing COBRA Continuation Coverage, the employer may allow the employee to request reimbursement for up to \$200, or the employee may elect COBRA Continuation Coverage to have access to \$2,400 by paying the applicable COBRA premium of \$200 per month on an after-tax basis

Interaction With COBRA

- ✦ Additionally, if an employer adopts a carryover or extended period for incurring claims, the maximum amount that a Health FSA may require to be paid as the applicable COBRA premium does not include unused amounts carried over or available during the extended period for incurring claims
- ✦ Thus, if a QB is allowed a carryover to a later plan year or an extended period for incurring claims, the applicable COBRA premium payable to provide access to the carryover amounts or the amounts attributable to the extended period for incurring claims for that later year or for the extended period for incurring claims is zero
- ✦ In addition, amounts carried over or available during the extended period for incurring claims are included in the amount of the benefit that a QB is entitled to receive during the remainder of a plan year in which a qualifying event occurs

FSAs — 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
 - > For example, no later than December 31, 2021 for an amendment that provides for a carryover of 2020 amounts from a calendar year FSA

OTC and Menstrual Care

- ✦ The CARES Act provided that Health FSAs, HSAs and Health Reimbursement Arrangements (“HRAs”) can pay for or reimburse for over-the-counter (“OTC”) drugs and medicines (without prescriptions). In addition, expenses for menstrual care products can be treated as qualified medical expenses which can be paid for reimbursed by a Health FSA, HSA, or HRA. This provision is effective for expenses incurred after December 31, 2019
- ✦ The Notice states that the general rule for amendments adding new benefits to a health plan or cafeteria plan, such amendment can only reimburse these new benefits to the extent that the expenses were incurred after the later of the amendment’s adoption date or its effective date
- ✦ The Notice provides relief from this general effective date rule with regard to the changes made by the CARES Act. The Notice states that regardless of when the amendment is adopted, a Health FSA or HRA can reimburse expenses for menstrual care products and OTC drugs incurred on or after January 1, 2020

FSA — Action Items!

- ✦ A company should consider taking the following actions related to the FSA CAA provisions:
 - > Discuss if 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
 - > Draft and adopt FSA plan amendments

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