UBA
Compliance Advisor

What every HR leader should know about compliance

Consolidated Appropriations Act, 2021

Part 3

Temporary Health FSA and DCAP Relief

10-Minute Read

Update 2/22/21: The Internal Revenue Service (IRS) issued Notice 2021-15 clarifying the relief provided under the Appropriations Act for health FSAs and DCAPs and provides additional cafeteria plan relief.

The Consolidated Appropriations Act, 2021 (Appropriations Act), enacted on December 27, 2020, contains temporary rules to provide relief for participants in health flexible spending arrangements (FSAs) and dependent care flexible spending arrangements (DCAPs) in light of the COVID-19 pandemic. The Appropriations Act builds on previously issued Internal Revenue Service (IRS) guidance (IRS Notice 2020-29 and 2020-33), by expanding the opportunities for plan sponsors to amend their plans to give employees additional opportunities to use their currently unused health FSA and DCAP amounts through 2022.

Carry Over of Unused Amounts

The Appropriations Act provides that health FSAs and DCAPs may permit participants to carry over any unused amounts remaining from the 2020 plan year to the plan year ending in 2021. Additionally, health FSAs and DCAPs may permit participants to carry over any unused amounts remaining in the health FSA or DCAP from the 2021 plan year to the plan year ending in 2022. IRS Notice 2021-15 clarifies that this carryover relief may be applied to plans that have a grace period, carry over, or neither. An employer has the discretion to allow the entire unused amount to be carried over or an amount less than the entire amount. An employer also has the discretion to limit the date by which the carried over amounts must be used during the subsequent plan year. Employers may allow participants to opt out of the carryover in order to have health savings account (HSA) eligibility (general purpose health FSA coverage is disqualifying coverage for HSAs). Note, the rule prohibiting health FSAs (and DCAPs) from adopting both a carryover and a grace period still applies. The IRS clarifies that amounts carried over will not be taken into account for purposes of the nondiscrimination rules applicable to Section 125 cafeteria plans and to

DCAPs under Section 129. Unused amounts carried over from prior years are not taken into account in determining the annual limit applicable for the following year.

Extended Grace Period

The grace period for using health FSA and DCAP amounts has also been extended. The Appropriations Act permits health FSAs and DCAPs to extend the grace period for participants to use remaining amounts for a plan year ending in 2020 or 2021, until 12 months after the end of the plan year. IRS Notice 2021-15 clarifies that an employer has the discretion to extend the grace period to less than 12 months after the end of the plan year. IRS Notice 2021-15 further clarifies that an employer may apply this grace period for health FSAs and DCAPs that do not have a grace period, but the rule prohibiting an employer from implementing a grace period and a carryover for health FSAs (and DCAPs) still applies. Unused amounts available during an extended grace period are not taken into account in determining the annual limit applicable for the following year.

Under the Appropriations Act, health FSAs may permit participants who cease to participate (due to termination of employment, change in employment status, or a new election, as clarified by IRS Notice 2021-15), during calendar year 2020 or 2021 to continue to use the remaining amounts for reimbursements through the end of the plan year (including any grace period) in which the participation ceased. IRS Notice 2021-15 clarifies that an employer may set a specific date within the plan year by which a terminated participant may continue to use the remaining amounts. IRS Notice 2021-15 further clarifies that an employer has the discretion to limit the unused amounts in the health FSA to the amount of salary reduction contributions the employee had made from the beginning of the plan year in which the employee ceased to be a participant. Note, this post-participation relief cannot be used if an employer is also implementing the carryover relief described above.

IRS Notice 2021-15 clarifies that employers may allow participants to opt out of the extended grace period or post-termination coverage in order to have health savings account (HSA) eligibility (general purpose health FSA coverage is disqualifying coverage for HSAs). The IRS also clarifies that amounts available during an extended claims period will not be taken into account for purposes of the nondiscrimination rules applicable to Section 125 cafeteria plans and to dependent care assistance programs under Section 129.

See Appendix A for examples.

DCAP Carry Forward

The current DCAP rules limit reimbursement of qualifying dependent care expenses to children under age 13. The Appropriations Act provides that DCAPs may extend the maximum age for dependents from 12 to 13 for eligible dependents who turned 13 (i.e., aged out of eligibility) during the last plan year with an open enrollment period ending on or before January 31, 2020. Participants are therefore permitted to use unused balances for qualifying reimbursements for expenses incurred on behalf of dependents who aged out during the pandemic. Employers can allow unused DCAP amounts for children until they turn age 14, at least through the end of the 2021 plan year (i.e., An employer can allow a participant to continue to reimburse expenses during the eligible plan year for a child under 14 subject to any applicable grace period. Or an employer could implement a carryover and allow a participant to continue to reimburse expenses during the subsequent plan year until the child(ren) turn age 14). Note, an employer is not required to implement a grace period or carryover under the relief described above in order to implement the DCAP relief under this section.

IRS Notice 2021-15 notes that employers may report the salary reduction amount elected by the employee for the year for dependent care assistance (plus any employer matching contributions) in Box 10 of an employee's W-2 and are not required to adjust the amount reported in Box 10 to take into account amounts that remain available in a grace period. The IRS provides that this rule continues to apply with respect to employers who amend their DCAP plans to provide for the DCAP carryover, extended grace period, or DCAP carry forward.

See Appendix B for examples of implementing a DCAP carry forward.

Midyear Election Changes for Health FSAs and DCAPs

In recognition of the continued impact that COVID-19 has had on the ability of participants to maximize the use of their health FSA and DCAP benefits, the Appropriations Act affords participants the opportunity to prospectively change existing health FSA and DCAP elections for 2021 at any time during the plan year ending in 2021 without a change in status. An employer may amend one or more of its Section 125 cafeteria plans to allow employees, on a prospective basis, to (1) 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 (2) revoke an election, make one or more elections, or increase or decrease an existing election, for plan years ending in 2021 regarding a DCAP. Prospective election changes may include an initial election to enroll in a health FSA or DCAP for the year (for example, a participant that had previously declined enrollment may be permitted to enroll). IRS Notice 2021-15 clarifies that an employer may limit the time period during which these prospective election changes may be made and may determine which prospective elections will be allowed. Employers are permitted to limit these midyear election changes to amounts that are not less than amounts that have already been reimbursed under the plan. The availability of 2021 midyear election changes in the absence of a change in status is consistent with IRS Notice-2029, which permitted such midyear elections during 2020. The health FSA and DCAP rules continue to prohibit the refund of previously contributed amounts.

An employer that allows employees to revoke elections midyear under their health FSA or DCAP may provide that amounts contributed before the election is revoked remain available to reimburse medical care expenses or dependent care expenses incurred for the rest of the plan year. Alternatively, the plan may provide that if the election is revoked, amounts contributed before the revocation will be available only to reimburse eligible expenses incurred before the revocation takes effect (and not later incurred expenses), or that amounts contributed before the revocation will be forfeited. These alternative two options would provide employees an opportunity to enroll in or contribute to their HSAs after the revocation takes effect.

See Appendix C for examples.

Health FSA Relief and COBRA

Under IRS Notice 2021-15, if an employer allows an employee who ceases to be a participant in a health FSA (for example, due to termination of employment or reduction in hours) to continue to reimburse expenses from unused amounts in the health FSA, this event would be a COBRA qualifying event (presuming the employer is subject to COBRA). The employer may allow the employee to request to continue to access the unused amounts (i.e., what has been contributed so far) or the employee may elect COBRA and have access to the full health FSA limit by paying the COBRA premium.

Under IRS Notice 2021-15, if an employer adopts a carryover or extended grace period, 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 grace period. The amounts carried over or available during the extended grace period are included in the amount of the benefit that a COBRA qualified beneficiary is entitled to receive during the remainder of the plan year in which a COBRA qualifying event occurs.

Midyear Election Changes for Cafeteria Plans

IRS Notice 2021-15 added that, similar to relief provided by IRS Notice 2020-29, an employer may amend one or more of its Section 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.

It appears than an employer may allow these election changes during the 2021 calendar year. However, an employer has the discretion to determine which of the above permitted election changes it will allow and the time period in which the election change may be made. The IRS noted that adoption of any of these permitted election changes will not cause the plan to fail Section 125 nondiscrimination testing.

In order for an employer to accept an employee's revocation of an existing election for employer-sponsored health coverage when the employee does not make a new election to enroll in different health coverage sponsored by the employer, 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 IRS provides the following 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).
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> Signature: _____

HSA Compatible and General-Purpose Health FSAs and HSA Contributions

IRS Notice 2021-15 provides that an employer may amend a cafeteria plan to allow an employee to make a midyear election to be covered by a general-purpose health FSA for part of the year and an HSA-compatible health FSA for part of the year. Only those expenses both allowed by the HSA-compatible health FSA and incurred during the months in which the employee was covered by the HSA-compatible health FSA may be reimbursed by that health FSA. Note, although unused amounts in the HSA-compatible health FSA may be added to the general-purpose health FSA (for example, if an employee makes a change from an HSA-compatible health FSA to a general-purpose HSA), the general-purpose health FSA may reimburse only allowable medical care expenses incurred after the change in coverage. If an employee is switching from a general-purpose health FSA to an HSA-compatible health FSA, any allowable medical care expense incurred during the months before the change in coverage may be reimbursed by the general-purpose health FSA. Note, although unused amounts in the general-purpose health FSA may be added to the HSA-compatible health FSA, only expenses both allowed by the HSA-compatible health FSA and incurred during months after the change in coverage may be reimbursed by the HSA-compatible health FSA.

The IRS provides that if an employee is covered under a high-deductible health plan (HDHP) at the beginning of the plan year without a health FSA and then elects coverage by a plan that is not an HDHP and coverage by a health FSA that can be used to reimburse medical expenses incurred while the employee was covered by the HDHP, the health FSA must be operated as an HSA-compatible health FSA for the months that the employee was otherwise an HSA-eligible individual in order for the employee to contribute to an HSA for those months. For months after the change in coverage, the health FSA may be operated as a general-purpose health FSA and may reimburse any allowable medical care expense incurred during the period after the change in coverage.

Additionally, the IRS permits employers to amend their plans to offer employees a choice between an HSA-compatible health FSA or general-purpose health FSA during the period to which a carryover or the extended grace period (that is implemented as noted above) for incurring claims applies. Also, employers are permitted to implement a plan design in which employees who elect an HDHP are automatically enrolled in an HSA-compatible health FSA.

Amendment Deadline

Employers may amend their health FSAs and DCAPs, to take advantage of the flexibility offered by the Appropriations Act, no later than the last day of the first calendar year beginning after the end of the plan year in which the change took effect. Accordingly, if the change takes effect January 1, 2021, the plan will need to be amended no later than December 31, 2022. Further, the plan must be operated in accordance with the amendment retroactive to the effective date.

Menstrual Care and OTC Drug Coverage Under Health FSAs and HRAs

The Coronavirus Aid, Relief, and Economic Security (CARES) Act allows employers to amend their account-based plans such as health FSAs, health reimbursement arrangements (HRAs), and HSAs to reimburse menstrual care products and over-the-counter (OTC) drugs without a prescription as qualified medical expenses that are incurred after December 31, 2019. Generally, for self-funded plans, such as health FSAs and HRAs that are subject to Section 105(b), qualified medical expenses may only be reimbursed if the plan covered the expense on the date the expense was incurred. Similarly, for plans provided through a Section 125 cafeteria plan, payment or reimbursement of expenses under the plan

may only be made for expenses incurred after the later of the amendment's adoption date or effective date for the new benefits. However, under IRS Notice 2021-15, health FSAs, and HRAs may be amended to provide for reimbursement of expenses for menstrual care products and OTC drugs without prescriptions incurred on or after January 1, 2020.

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Appendix A

Example 1. Employer provides a health FSA under a calendar year Section 125 cafeteria plan that allows a $550 carryover from one plan year to the next. Pursuant to Section 214 of the Appropriations Act, Employer amends the plan to adopt a 12-month temporary extended period for incurring claims with respect to the 2020 plan year, allowing for claims incurred on or after January 1, 2021, but prior to January 1, 2022, to be paid with amounts remaining from the 2020 plan year.

As of December 31, 2020, Employee A has a remaining balance of $2,000 in a health FSA for the 2020 plan year. For the 2021 plan year, Employee A elects to contribute $2,000 to a health FSA. Between January 1, 2021 and December 31, 2021, Employee A incurs $3,300 in medical care expenses. The health FSA may reimburse Employee A $3,300, leaving $700 in the health FSA as of December 31, 2021.

Pursuant to Section 214 of the Appropriations Act, Employer amends the plan to adopt the temporary extended period for incurring claims with respect to the 2021 plan year, allowing for claims incurred on or after January 1, 2022, but prior to January 1, 2023, to be paid with amounts remaining at the end of the 2021 plan year. For the 2022 plan year, Employee A elects to contribute $1,500 to a health FSA. Between January 1, 2022, and December 31, 2022, Employee A incurs $1,200 in medical care expenses. The health FSA may reimburse Employee A $1,200, leaving $1,000 in the health FSA as of December 31, 2022. Under the plan terms that provide for a $550 carryover from the 2022 plan year to the 2023 plan year, Employee A is allowed to use $550 of the remaining $1,000 in the health FSA during the 2023 plan year to reimburse expenses incurred on or after January 1, 2023, and before January 1, 2024. The $450 remaining as of December 31, 2022, is forfeited. A 2½ month grace period is not available for the plan year ending December 31, 2023, because the plan provides for a carryover.

Example 2. Employer provides a health FSA under a non-calendar year (July 1 to June 30) Section 125 cafeteria plan that allows a $550 carryover from one plan year to the next. Pursuant to Section 214 of the Appropriations Act, Employer amends the plan to adopt a 12-month temporary extended period for incurring claims with respect to the 2020 plan year, allowing claims incurred on or after July 1, 2021, but prior to July 1, 2022, to be paid with amounts from the 2020 plan year (which ends on June 30, 2021).

For the 2020 plan year, Employee B elects to contribute $1,800 to a health FSA. As of June 30, 2021, Employee B has a remaining balance in the health FSA for the 2020 plan year of $1,800. For the 2021 plan year, Employee B elects to contribute $1,000 to a health FSA. Between July 1, 2021, and June 30, 2022, Employee B incurs $2,000 in medical care expenses. The health FSA may reimburse Employee B $2,000, leaving $800 in the health FSA as of June 30, 2022. Under the plan terms that provide for a carryover, Employee B is allowed to use $550 of the remaining $800 in the health FSA during the 2022 plan year to reimburse expenses incurred on or after July 1, 2022, but prior to July 1, 2023. The $250 remaining as of June 30, 2022, is forfeited. A 2½ month grace period is not available for the plan year ending June 30, 2022, because the plan provides for a carryover.

Example 3. Employer provides a dependent care assistance program under a calendar year Section 125 cafeteria plan. Pursuant to Section 214 of the Appropriations Act, Employer amends the plan to adopt a 12-month temporary extended period for incurring claims with respect to the 2020 plan year, allowing for claims incurred on or after January 1, 2021, but prior to January 1, 2022, to be paid with amounts remaining from the 2020 plan year.

As of December 31, 2020, Employee C has a remaining balance of $4,000 in a dependent care assistance program for the 2020 plan year. For the 2021 plan year, Employee C elects to contribute $3,000 to a dependent care assistance program. Between January 1, 2021, and December 31, 2021, Employee C incurs $6,000 in dependent care expenses. The dependent care assistance program may reimburse Employee C $6,000, leaving $1,000 in the dependent care assistance program as of December 31, 2021.

Pursuant to Section 214 of the Appropriations Act, Employer amends the plan to adopt a 12-month temporary extended period for incurring claims with respect to the 2021 plan year, allowing for claims incurred on or after January 1, 2022, but prior to January 1, 2023, to be paid with amounts remaining at the end of the 2021 plan year. For the 2022 plan year, Employee C elects to contribute $2,000 to a dependent care assistance program. Between January 1, 2022, and December 31, 2022, Employee C incurs $2,800 in dependent care expenses. The dependent care assistance program may reimburse Employee C $2,800, leaving $200 in the dependent care assistance program as of December 31, 2022. A carryover is not available for a dependent care assistance program from the 2022 plan year to the 2023 plan year. Employer adopts a 2½ month grace period for the 2022 plan year, during which the $200 remaining as of December 31, 2022, may be applied to reimburse dependent care expenses incurred during the grace period.

Appendix B

Example 1. Employer provides a dependent care assistance program under a Section 125 cafeteria plan with a non-calendar plan year. The regular enrollment period for the 2020 plan year (March 1, 2020, through February 28, 2021) ended on January 31, 2020. Employee elected to enroll in the dependent care assistance program for the 2020 plan year, electing to contribute the maximum $5,000 allowed. Employee's Dependent turns age 13 on February 1, 2021. As of January 31, 2021, Employee has incurred no qualifying expenses for the 2020 plan year. However, Employee anticipates incurring dependent care expenses during February 2021, which is during the 2020 plan year.

Employer amends its Section 125 cafeteria plan by substituting "under age 14" for "under age 13" for the 2020 and 2021 plan years, making that change applicable to all amounts permitted under Section 214(d) of the Appropriations Act, and does not adopt any other relief provided by Section 214 of the Act. Employee incurs $5,000 in dependent care expenses in February 2021 for Dependent, who at that time is age 13. The $5,000 in dependent care expenses may be reimbursed by the dependent care assistance program for the 2020 plan year.

Example 2. Employer provides a dependent care assistance program under a Section 125 cafeteria plan with a non-calendar plan year. The regular enrollment period for the 2020 plan year (March 1, 2020, through February 28, 2021) ended on January 31, 2020. Employee elected to enroll in the dependent care assistance program for the 2020 plan year, electing to contribute $4,000. Employee's Dependent turns age 13 on February 1, 2021. As of January 31, 2021, 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.

Employer amends its Section 125 cafeteria plan to adopt the relief provided by Section 214(d) of the Appropriations Act by substituting "under age 14" for "under age 13" for the 2020 and 2021 plan years, making that change applicable to all amounts permitted under Section 214(d) of the Appropriations Act. Employer allows employees until the end of the next plan year to incur claims and does not adopt any other relief provided by § 214 of the Appropriations Act. Employee elects to contribute $500 for the 2021 plan year. Employee incurs $4,200 in dependent care expenses from June through August 2021 for Dependent, who during that time is age 13. For the 2021 plan year (March 1, 2021, through February 28, 2022), $4,000 of the $4,200 in dependent care expenses may be reimbursed by the dependent care assistance program for Dependent. ($4,000 is the unused amount from the 2020 plan year that may be applied to reimburse dependent care expenses during the subsequent plan year for a dependent that attained age 13 during the preceding plan year, until that dependent attains age 14, so the remaining $200 in dependent care expenses for Dependent may not be reimbursed.) Employee does not incur any other dependent care expenses during the 2021 plan year. The $500 remaining in the dependent care assistance program as of February 28, 2022, is forfeited.

Appendix C

Example 1. 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, amounts contributed before the revocation of the election remain available to reimburse medical care expenses incurred for the rest of the plan year and, therefore, the employee may use the $200 previously contributed to the health FSA to reimburse medical care expenses incurred throughout 2021. 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.

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 coverage during January and February will not make the employee ineligible to contribute to an HSA during the rest of the plan year if otherwise eligible.