CAA DEEP DIVE SERIES: HEALTH AND DEPENDENT CARE FLEXIBLE SPENDING ACCOUNTS

The Consolidated Appropriations Act of 2020 (CAA) was signed into law by President Trump on December 27, 2020. Among many other things, this law creates the option for employers to provide COVID-19 relief to both health and dependent care flexible spending arrangement account holders for 2021.

Many employers and employees hoped for this relief since the past year has not exactly gone "according to plan." Due to the global pandemic, employees have postponed medical care and treatment, and many dependents have been unable to attend in-person school leading to unexpected childcare needs. The uncertainty caused by COVID-19 makes it challenging for employees to make sound flexible spending account (FSA) election decisions.

In May of 2020, the Internal Revenue Service (IRS) gave employers the option to make some changes to help employees with FSAs for the 2020 plan year through Notices 2020-29 and 2020-33. The new law addresses many of the same issues for the 2021 plan year, including relief from the "use it or lose it" rules for flexible spending account holders. The CAA allows employers that sponsor health and dependent care flexible spending accounts to make the following plan changes.

- Group plan sponsors may allow employees to carry over their entire balance of unused funds from 2020 to 2021 and 2021 to 2022. The carryover flexibility applies to health and dependent care FSAs. Without opting for this relief, dependent care assistance plans may not permit carryovers, and health FSAs must limit carryover balances to $550 for 2020 and 2021.

- Employer plans that choose a spending grace period, rather than allowing funds to carryover, may extend those periods up to 12 months for plan years ending in 2020 or 2021. Ordinarily, grace periods are not greater than 2½ months.

- Employers may let terminated employees who participate in a health FSA to spend down their account balances through the end of the plan year of their termination. This option is available for calendar years 2020 and 2021, and the extra time a terminated employee has to spend down their funds includes any extended grace period. Typically, a terminated employee would lose access to their health FSA funds when they lost group health plan eligibility. The temporary change allowed by the

CAA means that if adopted, terminated participants will not need to elect COBRA and continue making health FSA contributions to access any remaining funds.

- Plan sponsors may permit prospective changes in election amounts for health and dependent care FSAs during the 2021 plan year, without a corresponding status change. A similar rule is already in place for plan years ending in 2020. Employers considering this option should be aware that allowing these changes for health FSAs could open up the possibility of overspending in the accounts.

- A group plan sponsor may temporarily extend the age of qualified dependent care beneficiaries from age 13 to 14 for both the 2020 plan year and for any unused funds that might be "carried over" or subject to an extended grace period, if the regular enrollment period was before January 31, 2020. This change could be helpful if a child had a 13th birthday during the pandemic, essentially preventing their parent from claiming any unexpected childcare expenses for that dependent. A parent could now count those costs as an eligible expense for reimbursement if their employer opts for this plan change.

Employers are not required to make any of these changes. If they choose to make some or all of them, a cafeteria plan amendment is required. However, employers have some time to update their Section 125 plan documents. The CAA gives them till the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective. In other words, a business with a calendar year plan that adopts changes for 2021 will need to execute a cafeteria plan amendment on or before December 31, 2022.

As of right now, the IRS has not issued any guidance to supplement the provisions of the new law and help employers with implementation, so some questions remain. For example, the law does not address how the new FSA relief works with health savings accounts. Health FSA enrollment disqualifies employees from eligibility to contribute to health savings accounts (HSAs) under longstanding IRS rules. So, for right now, employers that maintain or have recently transitioned to qualified high-deductible health plans compatible with HSAs need to be very cautious about adopting the carryover or grace period extensions. This is not a concern for those with dependent care FSAs or limited-purpose FSAs.

We expect that the IRS will issue guidance soon to address questions that employers and benefit advisors might have about executing newly allowed FSA changes. MZQ Consulting will continue to monitor developments and provide any relevant updates as additional information is released.