

THE DEEP DIVE

Exclusive Compliance Insights from MZQ Consulting

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CAA DEEP DIVE SERIES: HEALTH AND DEPENDENT CARE FLEXIBLE SPENDING ACCOUNTS UPDATED TO INCLUDE OPTIONAL MID-YEAR ELECTION CHANGES FOR HEALTH PLANS

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 (FSA) account holders for 2021.

And now, in a recent expansion of COVID-19 relief, the Internal Revenue Service (IRS) issued [Notice 2021-15](#) to create additional options for employers under Section 125 plans. The notice gives employers the **option** to allow mid-year health plan elections during 2021 without a qualifying event. The notice also expands further on the CAA health and dependent care FSA provisions and offers practical information about how that relief will work.

Health FSA and DCAP Relief

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 CAA 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.

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 FSA election decisions.

The CAA allows employers that sponsor health and dependent care FSAs to make the following plan change(s):

- 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 the original Deep Dive publication date, the IRS had not issued any guidance to supplement the provisions of the new law and help employers with implementation, so some questions remained. For example, the law does not address how the new FSA relief works with health savings accounts. Now with the newly issued IRS Notice 2021-15, we have practical guidance regarding many aspects of this new relief.

Some of the critical points that Notice 2021-15 addresses include:

- Employers that choose to access the Health FSA and/or DCAP relief may allow employees to carryover full account balances from the 2020 and/or 2021 plan years or extend their spending grace periods for up to 12 months for plan years ending in 2020 or 2021. However, they do not have to allow all remaining funds to carry over or extend a grace period that long. Instead, Health FSA and DCAP carryovers can be capped at any amount the plan sponsor chooses. Grace periods can be any length between the typical 2.5 months and the new maximum of 12.
- Employers are also permitted to make different choices for Health FSAs than they do for DCAP plans if they offer both and can elect to provide some form of relief for just one and not both if they choose.

An employer that offers multiple health FSAs or DCAPs may also adopt differing relief for each particular health FSA or DCAP option.

- Employers can limit Health FSA and DCAP mid-year election changes to amounts no less than amounts already reimbursed and certain types of mid-year election changes, such as decreases in elections only.
- Funds carried over or available during an extended claims period will not be taken into account for purposes of the nondiscrimination rules applicable to Section 125 plans and dependent care assistance programs under Section 129.
- Amounts carried over or available through an extended grace period do not count towards annual contribution limits. Also, when an employer reports DCAP contributions in Box 10 of Form W-2, they should not consider amounts that remain available due to an extended grace period or are carried over from the prior year.
- All amounts available on the last day of the 2020 or 2021 plan year are available for carryover, regardless of the funds' source. So, if someone carried over \$500 from 2019 to 2020 and then contributed \$2500 in 2020 and did not spend any of it, up to \$3000 could be carried over for use in 2021.
- For employers with plan years or grace periods ending in 2020, amounts made available during that extended claims period that remain unused as of December 31, 2020, are available to be carried over too.
- If an employer allows an expanded carryover, they can require employees to enroll in the Health FSA or DCAP with a minimum election amount to access the unused amounts from the prior plan year.
- If an employer adopts both a carryover from the 2020 calendar year to the 2021 plan year and the flexibility for mid-year election changes, and an employee later elects to participate in the health FSA or DCAP mid-year on a prospective basis, the carryover amount may be made available to reimburse employee expenses retroactive to January 1, 2021.
- For HSA contribution purposes, the carryover of unused Health FSA amounts to the 2021 plan year or the 2022 plan year will be considered non-HSA qualified coverage (except in the case of an HSA-compatible health FSA, such as a limited-purpose Health FSA). Therefore, an individual accessing those funds would not be eligible to make HSA contributions. However, an employer may allow employees, on an employee-by-employee basis, to opt-out of a carryover to preserve their HSA eligibility.
- For COBRA purposes, an employer cannot count funds carried over or available through an expanded carryover or extended period for incurring claims towards the health FSA COBRA premium.
- COBRA eligibility or an election is not necessary to qualify for a limited extension of Health FSA coverage incurred after the termination of participation and through the end of the plan year (including any grace period) if an employer elects that option for former participants.

Mid-Year Health Plan Elections for the 2021 Plan Year

Besides providing Health FSA and DCAP relief implementation guidance, Notice 2021-15 permits employers to allow employees to make prospective health, dental, or vision plan changes during the 2021 plan year without experiencing a qualifying life event. According to the guidance, an employer may amend one or more of its Section 125 plans to allow employees to:

1. Make a new election for employer-sponsored health, dental, or vision coverage on a prospective basis if the employee initially declined to elect employer-sponsored health coverage;
2. Revoke an existing election and enroll in a different plan sponsored by the same employer on a prospective basis (including changing enrollment from self-only coverage to family coverage); or
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 is important to note that just like with the Health FSA and DCAP changes, Notice 2021-15 aims to provide employers with maximum flexibility. No employer has to allow for any of these plan changes. Also, employers have the flexibility to let employees access all or any combination of the election change options. Group plan sponsors may limit any or all election change time-frames to specific dates. Furthermore, health insurance carriers and stop-loss carriers that underwrite group health plan benefits will need to weigh in on whether or not they will allow participants to make mid-year election changes.

This relief in Notice 2021-15 is very similar to what the IRS allowed employers to do in May of 2020 through Notice 2020-29 concerning employee health plan elections during the 2020 plan year. The relief applies to any group health insurance plan sponsor that offers pre-tax benefits via a Section 125 cafeteria plan, including fully-insured and self-funded group plans. Employers can take advantage of this relief right away, and groups have until the end of 2022 to make retroactive cafeteria plan amendments.

MZQ Consulting will continue to monitor developments about COVID-19 related plan relief. We will provide any relevant updates as additional information is released.

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