

# CAA Benefits Alert: Flexible Spending Account Relief in the 2021 Consolidated Appropriations Act

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The Consolidated Appropriations Act, 2021 (CAA) includes relief for plan sponsors offering Health Care and/or Dependent Care Flexible Spending Accounts (FSAs). These voluntary rules will benefit participants who have FSA funds left over due to medical care provider and school/daycare closures and remote work arrangements in 2020 as a result of the pandemic.

## Background

Health Care and/or Dependent Care FSAs may be offered as part of an employer's cafeteria plan. Under the rules governing cafeteria plans, FSAs are generally "use it or lose it" – that is, a participant will forfeit any amounts remaining in the FSA at the end of a plan year.

Prior to the CAA, Internal Revenue Service (IRS) guidance permitted certain FSA plan design options to prevent forfeiture of the amounts participants contributed to these FSAs. Specifically, a Dependent Care FSA could include a grace period of up to two months and 15 days past the end of the plan year for eligible individuals to incur eligible expenses under the FSA, and a Health Care FSA could include either (i) a grace period of up to two months and 15 days past the end of the plan year for eligible individuals to incur eligible expenses under the FSA or (ii) a carryover feature that rolls over a capped amount remaining in the Health Care FSA at the end of the plan year for use during the next plan year. For the 2021 tax year, the maximum carryover amount for the Health Care FSA is \$550. A Health Care FSA may not have both a grace period and a carryover feature.

Previous IRS guidance issued in response to the COVID-19 pandemic expanded these rules by allowing plan sponsors to extend through December 31, 2020 an FSA's grace period ending in 2020, and permitted non-calendar year FSAs with plan years ending in 2020 to pay or reimburse eligible expenses incurred through December 31, 2020.

## Carryovers Permitted for Plan Years Ending in 2020 and 2021

For plan years ending in 2020 or 2021, the CAA permits cafeteria plans offering Health Care FSAs and/or Dependent Care FSAs to include a carryover feature. For plan years ending in 2020, the FSA may allow participants to carry over unused amounts remaining in the FSA at the end of the plan year to the plan year ending in 2021. For plan years ending in 2021, the FSA may allow participants to carry over unused amounts remaining in the FSA at the end of the plan year to the plan year ending in 2022.

The CAA language provides that the permitted carryover would be allowed under rules similar to the rules generally applicable to health FSAs.

**Winston Takeaway 1:** *While not entirely clear, the CAA language indicates there is no limit on the amount that can be carried over from a Dependent Care FSA or Health Care FSA. Additional IRS guidance addressing the specific rules for CAA carryovers (including any limits) would be helpful. In addition, there is no mention of whether or not this relief also includes Limited-Purpose Health Care FSAs, but we assume it includes all Health Care FSAs, including Limited-Purpose.*

**Winston Takeaway 2:** *Employees may not contribute to a health savings account (“HSA”) while participating in a general purpose Health Care FSA. Employers will sometimes offer a limited purpose or post-deductible HSA to allow participants to take advantage of the carryover feature while still preserving their ability to make HSA contributions. In addition, IRS rules permit participants to waive carryover benefits, but not grace periods. Unless the IRS issues HSA relief guidance, this makes carryover a more flexible option for employees who wish to make HSA contributions.*

## Grace Period Extensions Allowed for Plan Years Ending in 2020 and 2021

For plan years ending in 2020 or 2021, the CAA permits cafeteria plans offering Health Care FSAs and/or Dependent Care FSAs with a grace period to extend the grace period to 12 months after the end of the plan year. This increases the maximum grace period length from two months and 15 days to 12 months.

In addition, the CAA permits FSAs to reimburse terminated participants for expenses incurred through the end of the plan year in which the participant ceased participation in the FSA, provided the participant terminated participation in the calendar year 2020 or 2021. (Please note that many Dependent Care FSAs already permit reimbursement for dependent care expenses incurred through the end of the plan year in which the participant ceased participation.) For this purpose, the end of the plan year in which the participant ceased participation in the FSA includes any grace period, including a grace period extended pursuant to the CAA.

**Winston Takeaway 1:** *Participants may not contribute to an HSA while General Purpose Health Care FSA funds are available to the participant during a grace period. Typically, participants with Health Care FSA funds left at the end of a plan year are not permitted to make HSA contributions until the end of the grace period. The CAA does not contain relief for participants who would be entitled to this grace period extension for General Purpose Health Care FSA funds during the prior plan year but who elected coverage under a HDHP with HSA for the following plan year. Unlike with carryovers, participants with a remaining balance cannot waive or decline coverage during the grace period. Further IRS relief on this issue would be welcomed.*

**Winston Takeaway 2:** *Plans contemplating offering terminated participants the ability to be reimbursed for expenses incurred through the end of the plan year in which participants terminate participation should assess the administrative burden of communicating to such participants and administering claims, particularly where the plan is also opting to extend the grace period to 12 months after the end of the plan year.*

**Winston Takeaway 3:** *The grace period and carryover relief provided by the CAA are optional. Plan sponsors may elect to adopt these extensions only for all FSA plans, for Dependent Care FSAs but not Health Care FSAs, or vice versa. In addition, plan sponsors may elect to apply the extension to the 2020 plan year but not the 2021 plan year.*

# Dependent Care FSA Exception for Dependents Who Age Out During Pandemic

The CAA increases the maximum age of a dependent for purposes of incurring eligible Dependent Care FSA expenses to 14, from 13, for certain Dependent Care FSA participants. This extension applies to a Dependent Care FSA participant who has one or more dependents who attain age 13 during the last plan year whose enrollment period ended on or before January 31, 2020 (the “2020 plan year”). For calendar year plans, the rule applies to a Dependent Care FSA participant with a dependent who turned 13 years old during calendar year 2020. In addition, this extension applies during the subsequent plan year if such a participant has unused amounts in the Dependent Care FSA at the end of the 2020 plan year (determined as of the FSA’s claims submission deadline for the 2020 plan year) after applying the extension.

**Winston Takeaway:** *This provision temporarily changes the limiting age for dependent care assistance under Section 21(b)(1)(A) of the Internal Revenue Code. This change would apply automatically to Dependent Care FSAs unless the plan specifically included an age 13 limitation (rather than a reference to the relevant Code section).*

## Permitted FSA Election Changes for Plan Years Ending in 2021

Under the CAA, FSAs may permit a participant to modify his or her elected FSA contribution amount on a prospective basis (subject to the IRS maximum dollar limitations on FSA contributions), for any reason. The participant need not have experienced a change in status or any other event to make this election change.

**Winston Takeaway:** *Plan sponsors adopting this change should clearly communicate the terms under which the plan will allow these changes to be made. While some plans may want to allow these changes at any time, others may want to limit the election change period to a specific time frame (similar to a mini open enrollment) to lessen the administrative burden. Also, it would be best to check with an FSA third-party administrator to see what and how that entity can administer this option.*

## Plan Amendments

Plans adopting any of the plan design changes permitted by the CAA must be amended by the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective. For example, a plan adopting the carryover for the Dependent Care FSA plan year ending December 31, 2021 must adopt the related plan amendment by December 31, 2022. In addition, the plan must be operated in accordance with the terms of the amendment from the date the amendment is effective, even if prior to the actual amendment adoption date.

**Winston Takeaway:** *The plan amendment provisions do not appear to alter the general rules for adding a new grace period feature or replacing a grace period with a carryover. Therefore, for the 2020 plan year, the permitted grace period extension would only apply to those FSAs that already have a grace period feature. Adoption of a grace period must be made by the end of the plan year to which it applies, which does not leave much time for calendar year plans that do not already have a grace period to adopt one for the 2020 plan year. Additional amendment relief to allow plan sponsors to take full advantage of the grace period extension would be welcome.*

## Conclusion

Plan sponsors should assess whether they want to take advantage of the relief offered to FSAs under the CAA, and discuss the implementation and communication of these changes with their third-party administrators. It is likely many participants have funds left over in their Health Care and Dependent Care FSAs due to medical care provider and school/daycare closures and remote work arrangements in 2020 as a result of the pandemic, and plan sponsors should determine whether utilizing the relief under the CAA can help avoid forfeiture of these amounts. In

addition, participants have already elected amounts to contribute to FSAs for the 2021 plan year and may need to adjust goal amounts to take into account these new carryover and grace period features.

Time is particularly of the essence for sponsors of calendar year FSAs looking to make any of these changes for the 2021 plan year. Any adopted changes should be promptly and clearly communicated to participants.

**This article is part of our “Unpacking the Employee Benefits Provisions in the Consolidated Appropriations Act, 2021” series. Click [here](#) for other CAA-related articles. Please contact a member of the Winston & Strawn Employee Benefits and Executive Compensation Practice Group or your Winston relationship attorney for further information.**

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