

# IRS Issues Guidance Addressing Flexible Spending Account and Other Relief

The [Consolidated Appropriations Act, 2021](#) (the “Act”) was signed into law on December 27, 2020. The Act includes flexible spending account plan relief, although it fell short of the relief participants wanted most. The Act did not permit flexible spending accounts (or their employer/plan sponsors) to refund unused balances from the 2020 plan year.

The IRS published [IRS Notice 2021-15](#) on February 18, 2021 (the “Notice”). This Notice provides additional guidance for the Act’s flexible spending account relief as well as additional election change relief for medical, dental, and vision coverage. Except where noted, the flexible spending account relief generally applies to both health care flexible spending account plans (HCFSA) and dependent care flexible spending account plans (DCFSA). We will refer to these collectively as “FSAs” in this Alert.

This Alert addresses the following relief and related items:

- [Unlimited FSA Carryovers](#)
- [Extended FSA Grace Periods](#)
- [Additional Guidance for Unlimited Carryovers and Extended Grace Periods](#)
- [HCFSA Spend-Down Feature](#)
- [Modified DCFSA Age Limit](#)
- [The Return of Amnesty Qualifying Life Events](#)
- [Amendment Timing](#)

The Act’s relief is optional, and employers/plan sponsors may choose to adopt all, some, or none of it. Some of the relief is available retroactively to 2020 plan years. For administrative reasons, employers wishing to apply relief to a 2020 plan year should consider implementing that relief by or before April 2021.

## Unlimited FSA Carryovers

FSAs *may* permit participants to carry over their entire unused FSA balances from a plan year ending in 2020 to a plan year ending in 2021, and/or from a plan year ending in 2021 to a plan year ending in 2022.<sup>1</sup> If adopted, this relief overrides the existing \$550 carryover limit applicable to HCFsAs and enables carryovers for DCFsAs.<sup>2</sup> This relief is available for both calendar and non-calendar plan year FSAs, but an unlimited carryover from a plan year that ended mid-2020 may be administratively impractical to implement now.

### Example 1



### Example 2



Employers may also: (1) restrict the unlimited carryover to a single plan year; (2) require participants to elect a minimum amount for the next plan year to receive unlimited carryovers (please also see [Additional Amnesty QLE FSA Guidance](#)); and/or (3) limit the availability of an unlimited carryover to only a portion of the next plan year. We suspect few employers will adopt (3).

An unlimited carryover simply becomes part of the next plan year's available funds and does not require the plan administrator to keep tracking a participant's remaining unused FSA balance from the prior plan year. As a limited downside, a participant cannot use the carryover amount to reimburse for expenses incurred during the prior plan year after its run-out and/or grace period expires.<sup>3</sup>

There is no IRS relief preventing a HCFSA carryover in a general purpose HCFSA from interfering with an individual's eligibility to make or receive health savings account (HSA) contributions during the following HCFSA plan year. The Notice confirms an employer can transfer unlimited carryovers from a general

<sup>1</sup> Run-out periods and grace periods do not count as part of the FSA plan year for this purpose.

<sup>2</sup> DCFsAs cannot use a carryover feature without this relief.

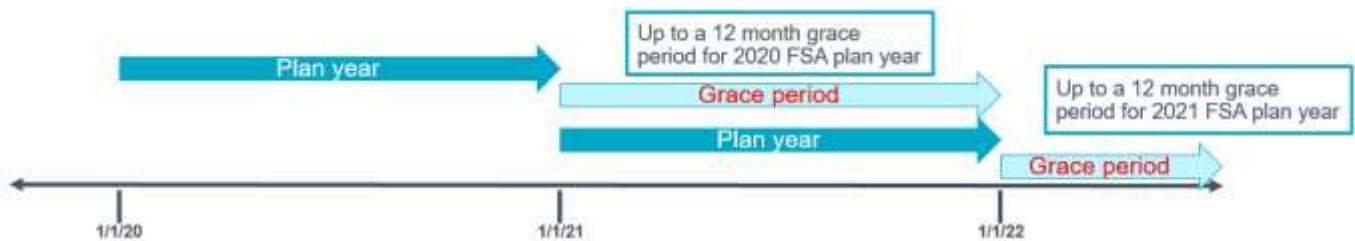
<sup>3</sup> Outbreak Period relief may apply. Please see our previous [Alert](#).

purpose HCFSA to a limited purpose or other HSA-compatible HCFSA.<sup>4</sup> This can be limited to those who elect high deductible health plan coverage and avoid potential HSA conflict for the following plan year, although the HSA-compatible HCFSA must already exist to receive the carryover and cannot be retroactively adopted.

## Extended FSA Grace Periods

FSAs *may* allow for grace periods of up to 12 months for plan years ending in 2020 and/or 2021. An FSA may adopt a shorter extended grace period. This relief is available for both calendar and non-calendar plan year FSAs, but an extended grace period for a plan year that ended mid-2020 may be administratively impractical to implement now.

### Example 1



### Example 2



A “run-out period” means a participant has a specific period after the end of the FSA plan year to submit claims incurred during the plan year. By contrast, the term “grace period” means a participant has a specific period after the end of the FSA plan year to submit claims incurred during that plan year **and** during the grace period. FSA grace periods are limited to 2 ½ months after the end of the prior plan year unless the FSA adopts this extended grace period relief.<sup>5</sup>

An extended grace period requires the plan administrator to track a participant’s remaining unused FSA balance from the prior plan year. An upside is that a participant can use the remaining unused balance to reimburse expenses incurred during the prior plan year for the duration of the entire extended grace

<sup>4</sup> HSA-compatible HCFSA’s include both limited purpose HCFSA’s and post-deductible HCFSA’s.

<sup>5</sup> Unlike traditional carryovers, traditional grace periods are available for DCFSA’s although they are uncommon.

period. This feature may not prove that significant for 2020. Participants likely have unused 2020 FSA balances because they did not have enough qualifying expenses to in 2020 due to delays/cancellations for medical care or dependent care provider closures.

If an individual has an unused balance as of the end of the HCFSA plan year, there is no IRS relief preventing a general purpose HCFSA from interfering with an individual's eligibility to make or receive HSA contributions during an extended grace period. Unexpectedly, the IRS Notice permits transfers between a general purpose HCFSA and HSA-compatible HCFSA (and vice versa) for the extended grace period similar to the carryover rules.<sup>6</sup> This can avoid a potential HSA conflict for the following plan year, although the HSA-compatible HCFSA must already exist to receive the transfer and cannot be retroactively adopted.

**Note:** The Notice does not address whether amounts transferred to a limited purpose HCFSA for an extended grace period are still available to reimburse general medical expenses incurred during the prior HCFSA plan year. We conservatively believe they are not and that the reimbursement rules for the limited purpose HCFSA apply upon transfer.

## Additional Guidance for Unlimited Carryovers and Extended Grace Periods

The Notice confirms that FSA amounts available in the following FSA plan year due to an unlimited carryover or during an extended grace period do not count against an employee's annual HCFSA contribution limit or DCFSA reimbursement limit for that following year. Similarly, these amounts do not count toward an HCFSA's COBRA premium calculation.

**Example:** An employer maintains a calendar year DCFSA and adopts the unlimited carryover from the 2020 to the 2021 plan year. Chris elects \$5,000 in DCFSA coverage for 2021 and has \$4,000 in unused DCFSA funds carried over from 2020. Chris may receive up to \$9,000 in tax-free DCFSA reimbursements for eligible dependent care expenses in 2021.<sup>7</sup>

The Notice limits the ability to use carryovers and grace periods in the same plan year as follows:

- An HCFSA can use a traditional carryover (current \$550 limit) and extended grace period during the same plan year;
- HCFSA's and DCFSA's can use an unlimited carryover with a traditional 2 ½ month grace period during the same plan year; but
- HCFSA's and DCFSA's cannot use an unlimited carryover and extended grace period during same plan year.

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<sup>6</sup> Please see footnote #23 in IRS Notice 2021-15.

<sup>7</sup> The American Rescue Plan Act of 2021 permits DCFSA's to increase the 2021 calendar year reimbursement limit to \$10,500 (\$5,250 for married couples filing separate tax returns).

In other words, if an employer maintains a calendar year DCFSA and adopts the unlimited carryover from the 2020 to the 2021 plan year, the employer cannot also implement the extended grace period ending December 31, 2021 for the 2020 plan year.

Finally, amounts available in a subsequent FSA plan year due to a carryover or grace period do not count toward the Internal Revenue Code nondiscrimination requirements for the subsequent plan year.

## HCFSA Spend-Down Feature

HCFSA *may* allow employees who terminate from the plan in 2020 or 2021 to spend down their unused balances for qualifying medical expenses incurred through the end of that HCFSA plan year without a COBRA election. For this purpose, a grace period – including the extended grace period described above – counts as part of the HCFSA plan year.

This relief does permit reimbursements for expenses incurred after termination for the remainder of the corresponding HCFSA plan year. This feature can ignore the HCFSA uniform coverage rule and limit reimbursements to a participant's remaining balance upon termination.

If the plan termination is due to a COBRA qualifying event, the plan administrator must still offer COBRA.<sup>8</sup>

**Note:** A spend-down feature already exists for DCFSA, although employers rarely adopt it.

## Modified DCFSA Age Limit

DCFSA *may* provide certain DCFSA age limit relief tied to two separate DCFSA plan years. We will refer to these plan years as “Year 1” and “Year 2” for relief purposes.

**Year 1** – Year 1 means the last DCFSA plan year with an open enrollment period that ended by or before January 31, 2020. This is easiest to explain through examples:

- The open enrollment period for a 2020 calendar year DCFSA occurred by or before January 31, 2020, so Year 1 is the 2020 DCFSA plan year.
- The open enrollment period for a June 1, 2019 – May 31, 2020 DCFSA plan year occurred by or before January 31, 2020, so Year 1 is the June 1, 2019 – May 31, 2020 DCFSA plan year.
- By contrast, the open enrollment period for a DCFSA plan year beginning on or after April 2020 probably did not occur by or before January 31, 2020, so a plan year beginning on or after April 2020 is not a Year 1 DCFSA plan year (but it may be Year 2). The latest DCFSA

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<sup>8</sup> This obligation does not apply to “overspent” HCFSA. An HCFSA does not need to offer COBRA to an individual whose reimbursements exceed their contributions as of the COBRA qualifying event date.

plan year that will qualify as Year 1 is likely a DCFSA plan year beginning in February or March of 2020.

**Year 2** – This is the next DCFSA plan year beginning after Year 1.

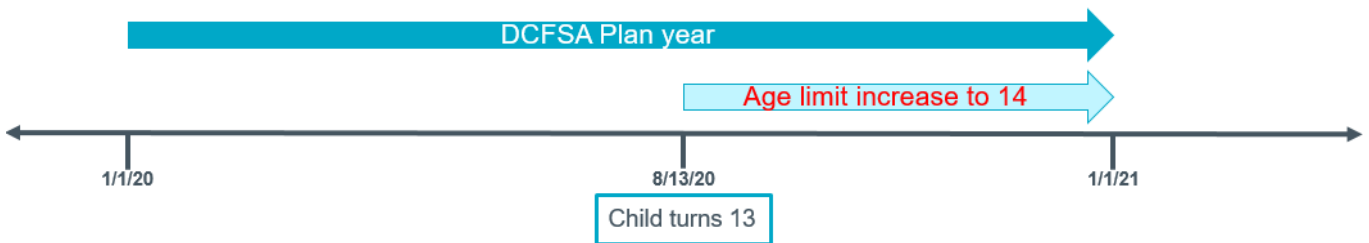
- If the 2020 calendar plan year is Year 1, Year 2 is the 2021 calendar plan year.
- If the June 1, 2019 – May 31, 2020 plan year is Year 1, Year 2 is the June 1, 2020 – May 31, 2021 plan year.

**Note:** This means Year 1 is already over for all DCFSAs and Year 2 is already underway. This relief may be impractical for non-calendar year DCFSAs, particularly when Year 1 ended mid-2020.

**Year 1 Relief**

If a DCFSA participant’s child turned 13 during Year 1, the age limit increases to 14 years old for the remainder of the DCFSA plan year.

Example

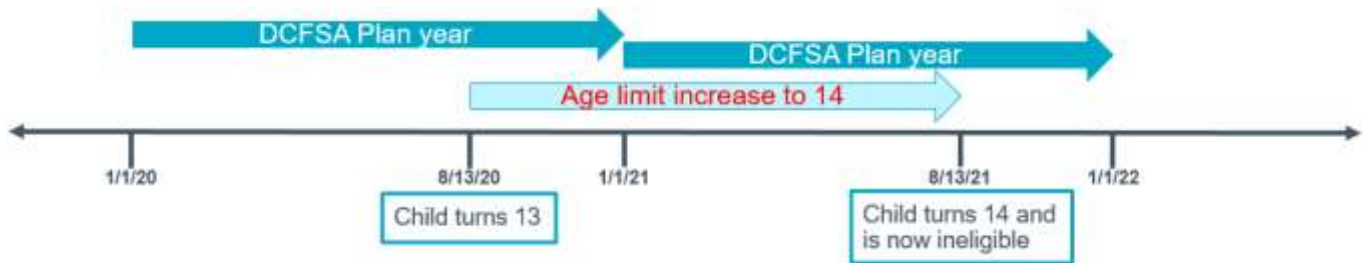


**Year 2 Relief**

Year 2 relief is available in two situations.

**Situation #1** – If a DCFSA participant’s child turned 13 in Year 1, the Notice permits any unused balance at the end of Year 1 to be available to reimburse for that child’s eligible expenses during Year 2 until the child turns 14. This is effectively a continuation of Year 1 relief through a portion of Year 2.

Example

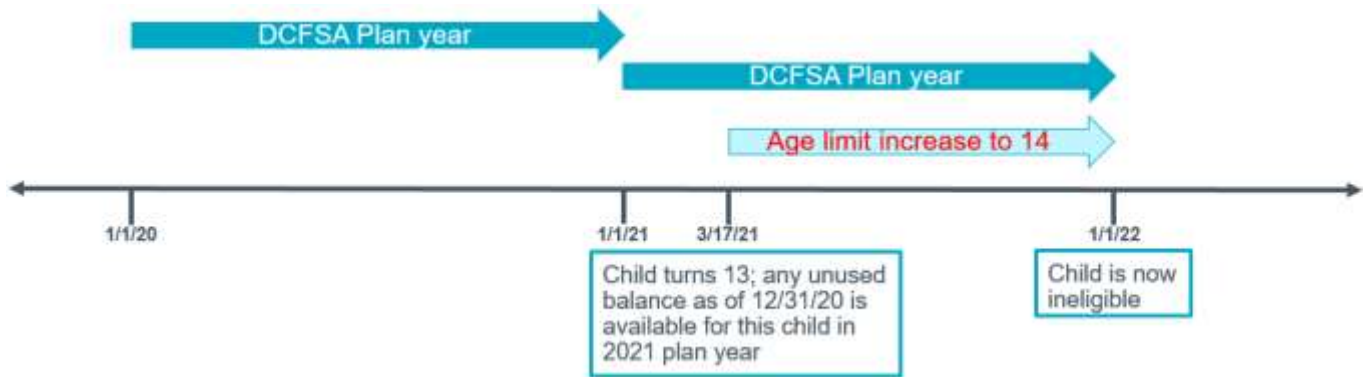


**Situation #2** – If a DCFSA participant:

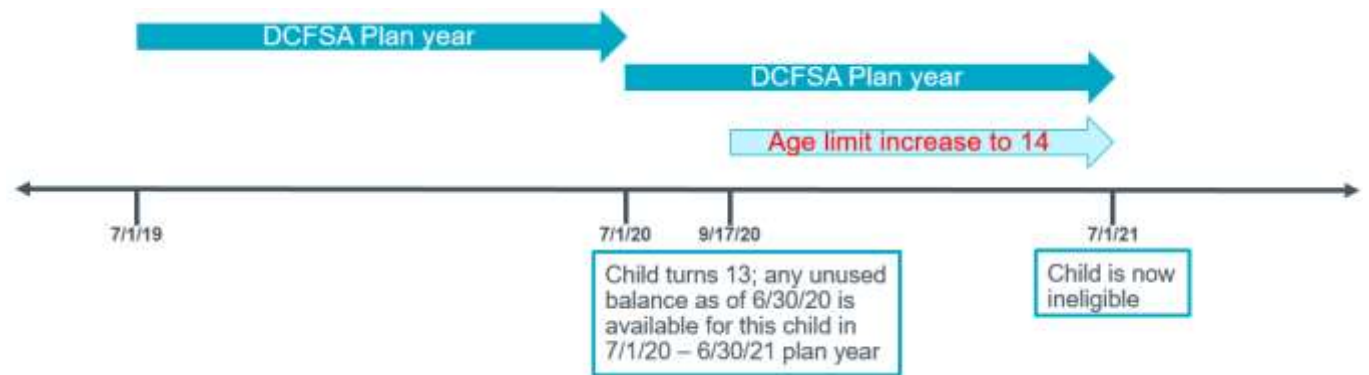
- Has an unused balance at the end of Year 1; and
- The participant’s child will turn 13 during Year 2; then
- The age limit for that child increases to 14 for Year 2; and
- The participant may use the remaining unused balance from Year 1 to pay for qualifying child expenses for that child during Year 2. A participant may only use new Year 2 elections to pay for expenses for the affected child through the child’s 13<sup>th</sup> birthday.

This relief ends at the end of Year 2 and does not continue until the child’s 14<sup>th</sup> birthday the following year. In other words, there is no “Year 3” for this relief.

Example 1



Example 2



In this Example 2, Year 2 began nine months ago. This highlights the potential administrative difficulty when applying the relief to non-calendar year DCFSA plans.

## Other Issues

The Notice indicates the unused balance from Year 1 is only available to pay for the qualifying expenses of the affected aged-out child(ren) during Year 2. It is not available to reimburse the expenses of other dependents. An employer could solve this by also adopting the unlimited carryover or extended grace period.

The Notice does not directly address whether an unused balance from Year 1 available for Year 2 reimbursements counts toward the annual \$5,000 DCFSA reimbursement limit for Year 2. We believe it does not given the IRS guidance that unlimited carryovers and amounts available due to an extended grace period do not count toward the limits for subsequent years.

## The Return of Amnesty Qualifying Life Events

In general, Internal Revenue Code Section 125 cafeteria plans may only allow pre-tax mid-year election changes if an employee experiences a qualifying life event (QLE) permitted under the cafeteria plan rules. In 2020, the IRS created what we will refer to as an “amnesty QLE” in response to the COVID-19 pandemic. The 2020 amnesty QLE period expired as of December 31, 2020.

IRS Notice 2021-15 generally revives this amnesty QLE for plan years *that end in 2021*. During this revived amnesty QLE period, a cafeteria plan may permit employees to make changes to pre-tax elections for medical, dental, vision, and FSA coverage as an amnesty QLE when no traditional QLE exists.<sup>9</sup>

**Note:** This means an amnesty QLE is not available for a plan year that begins after January 1, 2021 unless the plan runs a short plan year (for whatever reason).

## A Flexible Blank Slate

Employers have enormous flexibility to adopt and tailor amnesty QLEs to meet their needs, including:

- **Yes or no** – An employer can implement an amnesty QLE, but it is not required to do so.
- **Which benefits are affected** – An employer has the freedom to choose which benefits are subject to the amnesty QLE. For example, an employer may limit the amnesty QLE to just medical coverage, medical coverage and FSAs, just FSAs, etc.
- **Permitted election changes** – An employer has the freedom to choose which types of benefit election changes to permit. For example, an employer may:
  - Permit any election change;
  - Permit any enrollment or drop in coverage but not changes between plan options;
  - Only permit enrollment in the lowest cost medical plan; or

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<sup>9</sup> The amnesty QLE does not apply to other pre-tax benefits offered through the cafeteria plan. Remember that no QLE is required to change an HSA election



- Only permit an addition or drop of FSA coverage.

An employer should have the flexibility to limit which employee groups are eligible for the amnesty QLE provided it satisfies any applicable nondiscrimination rules.

**Note:** Employers should confirm permitted election changes with any applicable insurance carriers (including stop-loss carriers) *before* implementation. An insurance carrier may not agree to administer certain election changes because of adverse selection concerns.

- **When to allow amnesty QLEs** – An employer can choose when to permit an amnesty QLE. We believe most employers will choose to administer amnesty QLEs during a limited enrollment window rather than on an ongoing basis.
- **Prospective only** – With limited exception for FSAs addressed below, the permitted election changes are prospective only.

### **Additional Amnesty QLE FSA Guidance**

FSAs can [and should] prohibit elections to reduce FSA coverage below amounts already reimbursed for the plan year.

An FSA may allow participants adding or increasing FSA coverage to submit expenses incurred retroactive to the first FSA plan year beginning on or after January 1, 2021. Since amnesty QLEs are only available for plan years ending in 2021, this effectively means the retroactive FSA coverage only applies to a 2021 calendar plan year FSA (barring a short plan year). Beware of potential HSA conflicts.

FSAs may permit participants to use an amnesty QLE to take advantage of an unlimited carryover or extended grace period from the prior plan year, although this may prove administratively impractical to implement.

If an employer permits employees to revoke FSA coverage using this relief, there are three reimbursement limitation options:

1. The FSA may limit reimbursements for expenses incurred through the termination date during a corresponding run-out period. For an HCFSA, this resolves a potential HSA conflict on the termination date.
2. The FSA may prevent all reimbursements for expenses, whenever incurred, after the termination date. This also resolves potential HSA conflicts on the termination date, but it feels unnecessarily harsh.
3. The FSA may use the spend-down feature and permit reimbursements for expenses incurred after the termination of FSA coverage through the end of that FSA plan year. For an HCFSA, this conflicts with HSAs through the remaining HCFSA plan year.

### Additional Amnesty QLE Medical, Dental, and Vision Coverage Guidance

An employee may only drop medical, dental, or vision coverage if the employee has other similar coverage or will shortly enroll in other similar coverage. An employer may rely on an employee's written attestation as evidence of current or pending enrollment in other coverage, unless the employer has actual knowledge that the employee is not enrolled or will not enroll in other health coverage. IRS Notice 2021-15 provides the following sample attestation:

Name: \_\_\_\_\_ (and other identifying information requested by the employer for administrative purposes).

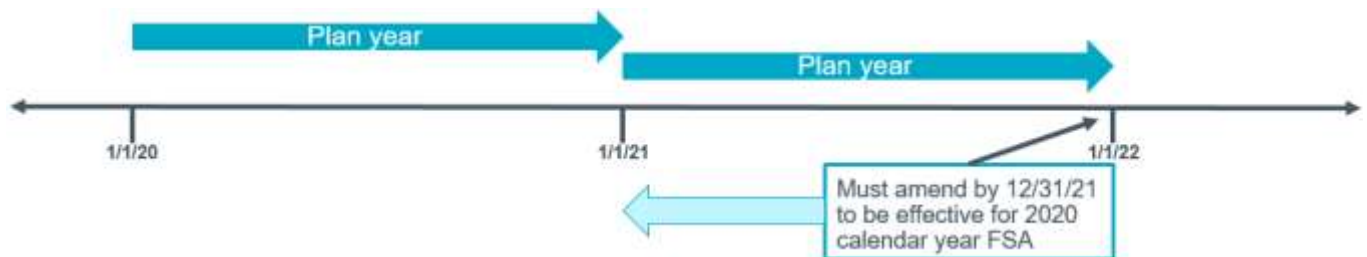
I attest that I am enrolled in, or immediately will enroll in, one of the following types of coverage: (1) employer-sponsored health coverage through the employer of my spouse or parent; (2) individual health insurance coverage enrolled in through the Health Insurance Marketplace (also known as the Health 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).

Signature: \_\_\_\_\_

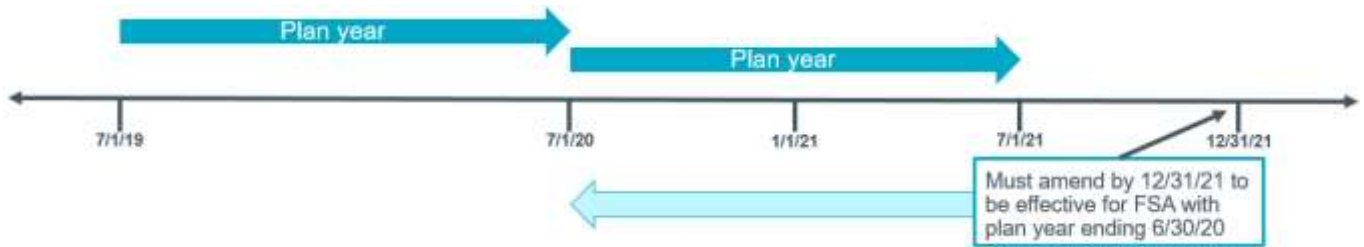
### Amendment Timing

Amendments for relief are effective retroactive to a given plan year if adopted by the end of the first calendar year beginning after the end of that plan year. The plan administrator must administer the plan consistently with the amendment from its intended effective date through its later adoption date.

#### Example 1



#### Example 2



**Note:** The amendment timing rules do not cover the existing unlimited spend-down feature for DCFSA's. If an employer wishes to implement this feature for its DCFSA, it must do so prospectively and should begin to take steps to implement this feature before the next DCFSA plan year begins.

## About the Author



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