

## IRS Guidance on CAA Coronavirus Relief for FSAs, DCAPs and Cafeteria Plans

Alert

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On February 18, 2021, the IRS issued [Notice 2021-15](#), clarifying temporary special rules for cafeteria plans, health flexible spending accounts (FSAs) and dependent care assistance programs (DCAPs) that were included in the Consolidated Appropriations Act (CAA) enacted on December 27, 2020. The notice also adds temporary opportunities to make changes in health plan coverage under a cafeteria plan. The notice provides lots of flexibility to employers wishing to implement these special rules.

### Flexibility for Carryovers and Grace Periods

The CAA allows plans that include health flexible spending arrangements or dependent care assistance programs to carry over all unused contributions from 2020 and 2021 to the immediately following plan year. Without the CAA relief, the carryover amount is limited to \$550 for health FSA amounts unused in 2020; carryovers are not normally permitted for DCAPs. Similarly, plans may extend the claims period up to 12 months after the end of the plan year for unused contributions remaining in a health FSA or DCAP at the end of the 2020 and 2021 plan year. Without the CAA relief, the post-plan year period for incurring claims (the "grace period") is limited to two months and 15 days.

Employers may adopt either the CAA carryover or grace period relief, even if they currently provide either a carryover or grace period, or if they previously did not provide either feature. Employers adopting the CAA carryover may limit the carryover amount and limit the time period for incurring claims. Employers adopting the CAA grace period may limit the period to less than 12 months. Any limits on accounts apply to the year in which the amount is contributed, not to any amounts available due to the carryover or grace period.

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The unused contributions available for use in the following year include all amounts remaining in the employee's account at the end of the plan year, except those amounts remaining solely because of the coronavirus outbreak-related extension of a grace period ending in 2020.

## Post-Termination Reimbursements from Health FSAs

The CAA permits plans that provide grace periods for health FSAs (similar to the rules applicable to DCAPs) to allow employees who cease participation during 2020 or 2021 to continue to receive reimbursements from unused contributions for expenses incurred through the end of the year in which participation ceased, including any grace period or extended grace period with respect to that year. For plans that provide carryovers, reimbursements may only be made for expenses incurred through the end of the year in which participation terminated.

The guidance clarifies that employers may limit the unused amount available in a health FSA to the amount of contributions the employee has actually made up to the date the employee ceased to be a participant rather than the full amount elected by the employee for the year. This applies to employees who cease to be participants due to termination, a change in employment status, or a new election during 2020 or 2021.

## Interaction with COBRA

Under certain circumstances, qualified beneficiaries who lose coverage under a group health plan, including health FSA, may elect continuation health coverage under COBRA.

The guidance clarifies that a limited extension of coverage under a health FSA does not prevent an otherwise qualified beneficiary from having a loss of coverage resulting from a qualifying event (such as termination of employment). The employer will be required to provide the individual with notice of the right to elect COBRA coverage. For example, if an employee elected to contribute \$2,400 to a health FSA and terminated employment on January 31 after making \$200 in salary reduction contributions, the employer may allow the employee to request reimbursement up to \$200, or the employee may elect COBRA continuation coverage to have access to \$2,400 by paying the applicable COBRA premiums of \$200 per month.

In addition, if an employer adopts the CAA carryover or 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 extension period.

Regardless of the employee's COBRA election, if the employer amended the plan to allow post-termination reimbursements from health FSAs, the employee could be reimbursed for expenses incurred through the end of the plan year and through any grace period provided under the plan.

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## Impact of CAA Health FSA Carryovers and Grace Periods on HSA Eligibility

Eligibility to contribute to a health savings account (HSA) is determined on monthly basis. Generally, an individual is eligible in any month if the individual (i) is covered by a high deductible health plan (HDHP) as of the first day of the month, and (ii) is not covered under any other health plan (with certain exceptions), such as a general purpose health FSA. General purpose health FSA CAA carryovers or grace periods for an employee who moves from a non-HDHP to an HDHP the following year would make the employee ineligible for HSA contributions. This would also apply to terminated employees who may still incur expenses reimbursable from their general purpose health FSA.

To avoid this result, employers may amend their plans to allow employees, on an employee-by-employee basis, to opt-out of the CAA carryover or grace period to preserve HSA eligibility, or to make a mid-year change to be covered under an HSA-compatible FSA for part of the year.

If an employee makes a mid-year election change in coverage from a general purpose health FSA to an HSA-compatible FSA or vice versa, the employee's permissible HSA contribution is based on the number of months the individual was covered under the HSA-compatible FSA and an HDHP.

## Special Age Limit Relief Applicable to Carryovers for DCAPs

The CAA temporarily increases the age at which a child is no longer eligible for DCAP reimbursement from 13 to 14. This special age limit rule applies to employees who are enrolled in a DCAP for the last plan year for which the end of open enrollment was on or before January 31, 2020 (the "2020 plan year") and has one or more dependents who attain age 13 either (i) in the 2020 plan year, or (ii) in the case of an employee who has unused DCAP amounts for the 2020 plan year, in the 2021 plan year.

The guidance clarifies that this special age rule is separate from the CAA carryover and grace period. Employers are not required to adopt the CAA carryover or grace period to adopt the age limit relief. If an employer adopts this special rule, then all amounts from the 2020 plan year may be applied to dependent care expense for a dependent who attained age 13 during that plan year. In addition, employers may allow employees to carry over all unused amounts from the 2020 plan year to reimburse dependent care expenses in the 2021 plan year for dependents until they reach the age of 14. The special age limit rule does not permit employers to reimburse expenses for dependents who are 14 years or older.

## Mid-Year Election Changes to Health FSAs and DCAPs

Generally, elections under cafeteria plans must be irrevocable and made prior to the first day of the plan year. The CAA allows plans to permit employees to make prospective mid-year changes to health FSAs and DCAP elections in plan years ending in 2021, regardless of any change in an employee's status.

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The notice clarifies that an employer may adopt an amendment allowing employees to revoke an election, make one or more elections, and increase or decrease an existing election. An employee, who initially declined to enroll, may also elect to enroll in a health FSA or DCAP for the year.

Employers have a lot of flexibility in implementing mid-year elections. An employer may limit the number of elections an employee may make and determine the extent to which election changes are permitted, provided any election change is applied on a prospective basis. For example, employers may allow amounts contributed prior to a mid-year election change to cease contributions to be used to reimburse expenses incurred through the entire plan year, or may limit reimbursements to expenses incurred prior to the mid-year change. Similarly, amounts contributed after a mid-year election to commence contributions may be used to reimburse expenses incurred at any time during the year, even prior to the election, or the employer could choose to limit reimbursements to expenses incurred after contributions began. In addition, employers may require that any changes not reduce the annual election to less than the amount already reimbursed, and may limit elections to certain types of changes (such as decreases only) or to certain time periods. Any rules must apply uniformly to participants.

## Mid-Year Changes in Health Plan Coverage and HSAs

The notice allows additional flexibility for plans to allow changes in health coverage, where these changes would otherwise be impermissible under cafeteria plan rules. A plan may be amended to allow an employee who initially declined coverage to add it, to change from one type of coverage offered by the employer to another, or to drop coverage if the employee attests in writing that they are enrolled, or immediately will enroll, in other comprehensive coverage. The notice provides sample language for the attestation and provides that an employer can rely on the attestation unless the employer has actual knowledge to the contrary.

Employees who change comprehensive health plan coverage may also want to make changes in their health FSAs. An employer may amend its plan to allow employees to make mid-year elections to be covered by a general purpose health FSA for part of the year and an HSA-compatible FSA for part of the year. Employers may offer employees a choice between an HSA-compatible FSA and general purpose FSA, on an employee-by-employee basis. In addition, an employer may automatically enroll employees who elect HDHP coverage into HSA-compatible FSAs.

## Plan Amendments

Plans must adopt an amendment implementing relief under the CAA by the end of the calendar year following the plan year in which the amendment is effective. For example, a calendar year plan that is amended to carry over the entire unused amount remaining in health FSAs on December 31, 2020, must adopt an amendment by December 31, 2021. The plan must operate in accordance with the amendment

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from the effective date of the amendment to the date the amendment is adopted. Employers should consider the timing of participant communications and notices to ensure employees can utilize the flexibility provided by any amendments.

## CONTACTS

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