

Flexibility for Flex Accounts – Congress Provides New Relief to Employees

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Under the Consolidated Appropriations Act, 2021 (H.R. 133)(the “Act”) ([here](#)), which was signed into law on December 27, 2020, new relief is available for employees who participate in health care flexible spending accounts and dependent care flexible spending accounts (“FSAs”). While the Internal Revenue Service (“IRS”) issued limited relief for FSA participants in 2020 ([here](#)), that guidance only expanded opportunities to make mid-year elections. It did not address the desire of so many employees to extend access to their unspent FSA balances beyond the 2020 plan year.

The changes under the Act are intended specifically to address this concern. Importantly, the changes are optional. Employers who implement these changes will likely experience higher costs due to reduced forfeitures and changes in plan administration. Additionally, changes to health FSAs could adversely affect the participant’s eligibility to contribute (or receive contributions) to a health savings account. Below is a summary of the changes affecting FSAs:

Larger Carryover Balances

Generally, amounts that remain in an FSA at the end of a plan year are forfeited and no longer accessible to the employee (i.e. the “use-it-or-lose it” rule). With the elimination of many elective medical procedures, daycare closings, and at-home schooling during the pandemic, many FSA participants were unable to utilize their FSAs in 2020.

Under prior guidance issued by the IRS ([here](#)), plans may allow employees to carry over up to a specified dollar amount (\$550 in 2021) of the year-end balance for use in the subsequent plan year. Pursuant to the Act, however, there is no dollar limit on the amount that participants may be permitted to carry over with respect to a plan year that ends in 2020 or 2021. By allowing such a carryover, the employee will have access to the amount carried over to pay or reimburse covered expenses in a subsequent plan year.

Extended Grace Periods

As an alternative to a carryover feature, prior IRS guidance ([here](#)) allows a plan to provide for a grace period of up to 2.5 months following the end of the plan year to apply unused balances to covered expenses incurred during that period. A plan is not permitted to have both a carryover feature and a grace period. Accordingly, under this relief, a plan with a grace period for a plan year ending in 2020 or 2021 may extend such period for up to 12 months after the end of such plan year. As with the carryover relief described above, this will allow the employee to apply the unused balances to the payment of covered expenses throughout the subsequent plan year. Note, however, if the participant was planning on making contributions to a health savings account in 2021 or 2022, the extension of a grace period under a general flexible spending account will cause such participant to be ineligible to make (or receive) such contributions. Accordingly, the employer will want to ensure that the account is re-characterized as a limited purpose FSA during the extended grace period.

More Permissible Election Changes

As a general rule, elections under an FSA are irrevocable during the year absent a permissible election change event. As mentioned, the IRS issued guidance in 2020 to temporarily ease the application of these rules. The Act further allows plans to be amended to permit eligible employees to make a prospective change to their 2021 plan year FSA elections even if there is no change in status event. This relief is particularly helpful for employees participating in calendar year FSA arrangements who did not have an opportunity to consider the effects of the Act’s changes before 2021 elections became final.

Extended Period for Health Care Reimbursements

Participation in a health FSA is generally required to terminate when the employee terminates employment, except to the extent the employee is eligible for and makes a timely election for continuation coverage. On the contrary, coverage under a dependent care FSA is permitted to run through the end of the year in which such termination occurs (without an affirmative election by the employee). Under the Act, a health FSA may allow a participant whose employment is

terminated during calendar year 2020 or 2021 to continue to receive reimbursements through the end of the plan year in which such participation ceased (including any grace period, as may be extended in accordance with the Act).

Reimbursements for Aged-Out Dependents

An employee enrolled in a dependent care FSA may receive reimbursements of dependent care expenses for a child who has not attained age 13. The Act, however, increases the age to 14 for those employees who elected coverage under a dependent care FSA during an enrollment period that ended on or before January 31, 2020 and have dependents that attained age 13 during the 2020 plan year. Pursuant to this relief, an employee may receive reimbursements for expenses incurred for the remainder of the 2020 plan year and may use the balance in the 2021 plan year.

Plan Amendments

These changes are discretionary, but if any one or more of them is adopted, the employer must adopt a retroactive plan amendment not later than the last day of the first calendar year following the calendar year in which the amendment is first effective (i.e. for changes effective for calendar year plan year 2021, by December 31, 2022).

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