

FAQs: Coronavirus Relief Bill signed December 27, 2020

Temporary Special Rules for Health and Dependent Care Flexible Spending Arrangements (FSAs)

January 2021

1. If we adopt the temporary rules pertaining to the changes for FSA elections, when can employees make changes to their elections?

The bill authorizes plan amendments to allow election changes under a health FSA and/or a dependent care FSA (a/k/a DCAP) during the plan year ending in 2021. If the plan is a calendar year plan, that means employees could be allowed to make these election changes any time on or before December 31, 2021. If the plan is a fiscal year plan with a plan year ending, for example, on June 30, 2021, employees could be allowed to make these election changes any time on or before June 30, 2021. Keep in mind that these election changes, if made, are effective only on a prospective basis. They cannot impact contributions already made to the FSA. As a practical matter, most election changes under this new rule will be made well in advance of the last day on which the changes can be made.

2. Under the temporary rules pertaining to changes to FSA elections, is there any limitation on the frequency of changes that employees can make?

There is no specific limitation set by statute. Employers may allow unlimited health FSA and dependent care FSA election changes without a status change event OR may limit the frequency and/or circumstances under which employees may revoke and make new elections.

3. Can plan sponsors limit the number of FSA election changes (e.g., once per year without a status change)?

Yes. Nothing in the bill prevents the employer from limiting the number of FSA election changes without an intervening status change event.

4. Can plan sponsors limit the timeframe for applying for FSA election changes without a status change (e.g., set the special election change period of one month)?

Yes. Nothing in the bill prevents the employer from imposing a specific timeframe during which the special election changes must be made.

5. If we choose to allow EEs to change FSA elections mid-year with no change in status, are the election changes available only to EEs who elected the FSA for the plan year ending in 2021?

This is optional for the employer. The employer may allow both eligible employees and current participants to make election changes or may limit the ability to make these election changes only to participants.

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6. If we choose to allow EEs to change FSA elections mid-year with no change in status, can we restrict the types of changes allowed?

Yes. Nothing in the bill prevents an employer from limiting the types of election changes allowed. For instance, an employer could authorize only election changes to increase the annual benefit amount, or allow election changes to reduce the annual benefit amount only to the extent that the election is not reduced below the amount of reimbursements the employee has received.

7. Does the bill allow us to refund unused FSA account balances?

No. While the bill allows employers to amend their plans to allow employees to change their FSA elections during the plan year ending in 2021, such election changes must be effective prospectively, which means no refunds of amounts contributed prior to the date on which the election change is made are allowed.

8. Are the annual FSA limits based on the plan?

Health FSA limits are based on the plan year.

Dependent care FSA limits are based on the individual's tax year, which is the calendar year for most employees.

9. Do the temporary rules regarding FSA election changes contained in the bill allow election changes with respect to other benefits?

No. Unlike the prior relief provided by the IRS with respect to election changes during the 2020 calendar year, the temporary election change rules contained in the new relief bill apply only to FSA elections. For example, no relief was provided with respect to pre-tax elections for group health plan premiums.

10. Does the bill authorize an FSA to offer both a carryover and a grace period following the plan years ending in 2020 or 2021?

No. Employers must choose between the special carryover or grace period relief provided under the bill.

11. If a plan sponsor has both a health FSA and a dependent care FSA, can it elect to offer the temporary carryover for the dependent care FSA if it currently has a grace period on the health FSA but no grace period on the dependent care FSA?

Yes. The health FSA and dependent care FSA are separate accounts, even though they are part of the same overall cafeteria plan. Therefore, separate claims provisions can be adopted for each spending account. The employer may continue to administer the grace period for their health FSA and adopt a carryover provision for the dependent care FSA under the temporary flexibility rules.

12. If there is neither a grace period nor a carryover provision currently, can the plan sponsor adopt a new grace period for the 2020 plan year and allow for up to 12 months after the end of the plan year to incur expenses?

The legislation permits employers to extend an existing grace period for the current year, but it is unclear from the guidance currently available whether employers might be able to adopt a new grace period for the plan year ending in 2020. That said, it might be reasonable to interpret the legislation as allowing employers to do so if we look at the intent of the temporary flexibility contained in the Act. Because of this ambiguity, we recommend seeking legal advice for employers wishing to add a grace period to a 2020 plan year that has ended.

13. If the employer allows for the full carryover from the plan year ending in 2020 into the 2021 plan year, does the employer have to offer employees an opportunity to change their annual elections?

No. Each of the temporary relief measures included in the bill is independent of the other. The plan sponsor may adopt the temporary election flexibility, the carryover feature, or the plan sponsor may adopt both changes in tandem.

14. If an employer chooses to adopt a carryover provision for their dependent care FSA or health FSA, do the balances carried over have to be counted against the employee's dependent care FSA or health FSA limits during the next plan year?

The bill does not address this issue (i.e., it does not specifically change the current rules). Under existing rules regarding maximums:

- Funds carried into the new plan year under a health FSA will not impact the amount of FSA salary reductions that may be made for the next plan year
- The dependent care FSA rules limit the amount of non-taxable dependent care FSA benefits an individual may receive during his/her taxable year (i.e., the calendar year) to \$5,000 for an individual, head of household, or married taxpayer filing a joint return (\$2,500 for a married taxpayer filing a separate tax return from his/her spouse). At this time, it is unclear whether any carried over account balance plus any new salary reduction contributions made to the dependent care FSA could result in any reimbursements in excess of those limits becoming taxable.

15. If we extend the grace period under our health FSA and/or dependent care FSA, when will the extended grace period expire?

First, note that the bill authorizes employers to amend their plans to extend the grace period to a maximum of 12 months. An employer may choose to use a shorter extended grace period if it wishes to do so. Here are some examples of when the grace period will expire if the employer chooses to use the full 12-month grace period:

- For a calendar year plan, the extended grace period following the plan year ending December 31, 2020 will run until December 31, 2021.
- For a calendar year plan, the extended grace period following the plan year ending December 31, 2021 will run until December 31, 2022.
- For a fiscal year plan with a plan year ending June 30th, the extended grace period following the plan year ending June 30, 2020 will run until June 30, 2021.
- For a fiscal year plan with a plan year ending June 30th, the extended grace period following the plan year ending June 30, 2021 will run until June 30, 2022.

16. If we adopt the provision allowing former participants to continue to receive reimbursements under the health FSA during the remainder of the plan year, how long will we need to provide reimbursements to former employees?

According to the bill, a health FSA may be amended to allow an employee who ceases participation in the plan during the 2020 and/or 2021 calendar year to continue to receive reimbursements from his/her unused benefits or contributions (i.e., the account balance) through the end of the plan year in which such participation ceased including any grace period. Consider the following examples:

- Employee's participation in a calendar year plan terminates on March 15, 2021 due to a termination of employment. The health FSA has no grace period. At the time of termination, employee's account balance is \$1,000. Employee has until December 31, 2021 to incur reimbursable expenses and spend down the \$1,000 account balance.

- Employee's participation in a calendar year plan terminates on March 15, 2021 due to a termination of employment. The employer has adopted the 12-month grace period authorized by the bill. At the time of termination, employee's account balance is \$1,000. Employee has until December 31, 2022 to incur reimbursable expenses and spend down the \$1,000 account balance.
- Employee's participation in a fiscal year plan (with the plan year ending June 30, 2022) terminates on July 15, 2021 due to a termination of employment. The health FSA has no grace period. At the time of termination, employee's account balance is \$1,000. Employee has until June 30, 2022 to incur reimbursable expenses and spend down the \$1,000 account balance.

Employee's participation in a fiscal year plan (with the plan year ending June 30, 2021) terminates on March 15, 2021 due to a termination of employment. The employer has adopted the 12-month grace period authorized by the bill. At the time of termination, employee's account balance is \$1,000. Employee has until June 30, 2022 to incur reimbursable expenses and spend down the \$1,000 account balance.

17. If we adopt the provision allowing former participants to continue to receive reimbursements under the health FSA during the remainder of the plan year, must we notify former employees of that change?

While the bill does not address this issue, we recommend employers notify any former employees who would be impacted by the change.

18. Do plan sponsors have to adopt the changes in writing?

Yes. The changes do not occur automatically. The employer must decide to make the change and adopt a formal amendment to the plan. The amendment to the plan must be adopted no later than the last day of the first calendar year beginning after the end of the plan year for which the amendment is effective. Consider the following examples:

- If an employer wishes to adopt some or all of the temporary rules for the plan year ending December 31, 2020, the amendment(s) must be adopted by December 31, 2021.

- If an employer wishes to adopt some or all of the temporary rules for the plan year ending December 31, 2021, the amendment(s) must be adopted by December 31, 2022.
- If an employer wishes to adopt some or all of the temporary rules for the plan year ending June 30, 2021, the amendment(s) must be adopted by December 31, 2022.

Although a formal amendment can be adopted at a later date, we recommend that the changes be clearly communicated to participants as soon as possible.

Furthermore, the legislation states that if an amendment is adopted with a retroactive effective date, the plan must be operated consistent with the terms of such an amendment during the period beginning on the amendment's effective date and ending on the date the amendment is adopted.

19. If an employer wishes to adopt any of the temporary changes to its dependent care FSA and health FSA, what changes should be made to the plan document?

The plan sponsor must determine what changes they wish to make and the extent to which they want to allow any changes for plan years ending in 2020 or 2021. They will need to amend the cafeteria plan document to reflect their intent once they have decided what relief they wish to provide their plan participants. They should also amend the health FSA's SPD (or issue a Summary of Material Modification regarding the health FSA) and communicate changes made to the dependent care FSA to eligible employees. While Brown & Brown can help them determine what changes they wish to implement in accordance with the legislation and work with their third-party FSA administrators to implement those changes, plan sponsors should consult with their employee benefits attorney who can advise them on how to amend their documents.