
Flex Plans are Extra Flexible in 2021

Employers who sponsor a Section 125 cafeteria (“flexible benefits”) plan, including those with a health and/or dependent care flexible spending account (each a “FSA”), may adopt new rules for their plans under the Consolidated Appropriations Act, 2021 (the “CAA”), and related IRS Notice 2021-15 (the “Notice”). In addition to these optional changes, the American Rescue Plan Act of 2021 (“ARPA”) temporarily increases the maximum amount of dependent care FSA benefits that can be excluded from income in 2021.

Unlimited Carryover or Extended Grace Period

The CAA and Notice provide employers with two options for allowing employees to utilize unused health or dependent care FSA dollars for plan years ending in 2020 and 2021 (the previous guidance issued under IRS Notices 2020-29 and 2020-33 addressed unused amounts from 2019 only).

1. Employers can add (or, in the case of a health FSA, extend) a carryover feature to cafeteria plans that will allow participants to carry over any unused amounts remaining in a health and/or dependent care FSA at the end of the 2020 and 2021 plan years to the following plan year. Normally, the carryover feature is available to health FSAs only, and the maximum permitted carryover amount is \$550 (now indexed for cost of living changes under IRS Notice 2020-33). The CAA expands the carryover feature to dependent care FSAs and allows an unlimited amount to be carried over under either health or dependent care FSAs into the 2021 and 2022 plan years. The Notice clarified that employers can choose to implement a carryover limit, and can set a deadline by which carryover amounts must be used. The Notice also confirmed that, as with health FSAs, carryover amounts will *not* impact the annual maximum contribution allowed under a dependent care FSA (as described further below, the annual maximum for the dependent care FSA can be increased in 2021). Employers can also require participants to make contributions in 2021, in order to have access to 2020 carryover amounts.
2. Alternatively, employers can extend an applicable grace period to up to 12 months after the end of the plan year. Normally, the maximum allowable grace period for an FSA is 2 ½ months. This option increases the maximum grace period from 2 ½ months to 12 months for plan years ending in 2020 and 2021.

Both options effectively give employees up to an extra 12 months to utilize unused health and dependent care FSA amounts from 2020 and 2021. Employers that offer a high deductible health plan (“HDHP”) / health savings account (“HSA”) option should pay close attention to how extending any grace period or offering an expanded carryover for a health FSA impacts HSA

eligibility for employees who choose to enroll in the HDHP/HSA option for the subsequent plan year. Participants with health FSA funds left at the end of a plan year are not permitted to make HSA contributions in the subsequent year until the end of the grace period or carryover period (unless the left over health FSA funds are allocated to a “limited purpose” FSA). The Notice clarified that a plan can allow participants to opt out of the extended grace period or carryover, in order to preserve eligibility for the HSA.

The carryover relief and grace period extension under the CAA are optional. Employers may implement these changes for both the health and dependent care FSAs or for just one of the FSAs. In addition, employers may elect to utilize this relief for the 2020 or 2021 plan years or both. Note, however, that under existing IRS guidance, an FSA cannot have both a carryover and a grace period.

Health FSA Reimbursements for Terminated Participants

Health FSAs may be amended to permit employees who cease participation in the health FSA during calendar year 2020 or 2021 (for example, due to termination of employment) to “spend down” their accounts after termination, meaning they can continue to receive reimbursements from their FSA through the end of the plan year in which such participation ceased (including any grace period). Normally, health FSA participants may not be reimbursed for expenses incurred following termination unless they are eligible for and elect COBRA continuation coverage, which requires payment of COBRA premiums. Employers who decide to offer this option to participants must still provide COBRA notices, but, unlike under COBRA, need only give access to amounts already contributed, and not yet spent, at the time participation ceases.

Special Dependent Care FSA Carry Forward Rule for Dependents Who Aged Out During the Pandemic

The CAA takes into account the fact that some dependents may have attained the limiting age for dependent care FSA reimbursements during the pandemic, when schools and dependent care services were closed. Normally, a dependent care FSA can be used only to pay for qualifying dependent care expenses of a child who is under age 13. The CAA allows plans to temporarily increase this maximum age to 14 for the last plan year for which the annual open enrollment period was on or before January 31, 2020. Additionally, the dependent care FSA can be amended to allow participants to carry over unused amounts to the subsequent plan year and apply those amounts to qualifying dependent care expenses until the dependent reaches age 14.

Midyear Election Changes for FSAs during the 2021 Plan Year

Consistent with the relief provided in IRS Notice 2020-29 for 2020 plan year elections, the CAA permits employers to allow employees to change existing health or dependent care FSA elections previously made for the 2021 plan year, on a prospective basis only, at any time during the year, without a “change in status” event. Under the Notice, plans can also permit mid-year changes to medical, dental, or vision coverage elections, provided that, in the case of a revocation of health coverage, the participant certifies that he or she has obtained other coverage. A plan can place parameters on the election changes, such as only allowing an increase in medical coverage, or restricting participants from decreasing their annual FSA contribution amount below the amount that has already been reimbursed for the 2021 plan year. Plan sponsors can also choose to limit the timeframe for such midyear election changes and/or to limit the number of changes permitted.

The Notice clarified that plans may allow participants who make new FSA elections mid-year to seek reimbursements for claims incurred on or after January 1, 2021, even if they weren't yet participating as of that date. Plans also have flexibility to specify whether a participant who revokes his or her health FSA election mid-year is permitted to continue to spend down his or her outstanding balance for the remainder of the year. Plan sponsors should keep in mind that allowing a participant to spend down the account will make him or her ineligible to make HSA contributions.

Increased Dependent Care FSA Maximum Contribution

The ARPA further expanded dependent care FSA flexibility by increasing the maximum annual contribution amount from \$5,000 (\$2,500 for married individual filing separately) to \$10,500 (\$5,250 for a married individual filing separately). This is the first time in 35 years that the dependent care FSA maximum has been increased, but for now it only applies to the 2021 plan year. Like the changes described above, this is an optional increase for plan sponsors to consider.

Deadline for Plan Amendments

Employers that want to implement any of the CAA cafeteria plan changes must amend their plan documents by no later than December 31, 2021 (for changes applicable to the 2020 plan year) or no later than December 31, 2022 (for changes applicable to the 2021 plan year). An amendment increasing the dependent care FSA maximum must be adopted by December 31, 2021.

If you have questions or would like additional information about anything discussed in this Client Update, please contact a member of Maynard Cooper & Gale's [Employee Benefits & Executive Compensation practice group](#).

For more information on The American Rescue Plan Act of 2021 and benefits guidance, see our recent Client Update:

- [COBRA Provisions in the American Rescue Plan Act: Time is of the Essence for Employers](#)

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