



## IRS Clarifies FSA Relief and Provides Flexibility for Health Plan Elections

● February 2021 ●

On February 18, the IRS released Notice 2021-15 (the Notice) to clarify the application of the Flexible Spending Account (FSA) relief provided for under the Taxpayer Certainty and Disaster Relief Tax Act of 2020 (the Act). The Notice also provides additional flexibility under Internal Revenue Code Sec. 125 for group health plans.

### Clarity on FSA Relief Included in the Act

[The Act, which delivered a second round of COVID-19 stimulus funding, was signed into law by President Trump on December 27, 2020.](#) Also included in the Act are various provisions affecting FSAs – both Health FSAs and Dependent Care FSAs – that are aimed at providing plan participants with temporary flexibility in light of the ongoing public health emergency. These provisions are all optional for employer-sponsors, not mandatory.

In the Notice, the IRS issues important clarifications with respect to several of these provisions:

- **Unlimited Carryovers.** For FSA plan years ending in 2020 and 2021, employer-sponsors may allow for the carryover of all unused funds into the next plan year. In the Notice, the IRS reminds employer-sponsors that a plan cannot have a carryover if it also provides a grace period.

If an employer-sponsor chooses to implement this carryover feature, it may place a cap on the amount that can be carried over and may also limit the application or availability of the carryover funds up to a specified date in the plan year. Finally, employers and participants should be mindful that carryovers are an extension of FSA coverage and, with respect to Health FSA coverage, will be disqualifying for purposes of HSA eligibility unless the employee either waives the carryover amounts or converts the amounts to a Limited Purpose FSA.

- **Extended Grace Periods.** As an alternative to unlimited carryovers, FSA plan years ending in 2020 and 2021 may implement a grace period of up to 12 months. Again, a plan cannot have both a grace period and a carryover provision. If an employer chooses to incorporate an extended grace period into its FSA, it can select a period of time that is fewer than 12 months.

As a practical matter, the unlimited carryover and extended grace period provide similar relief, as both provisions allow all unused FSA balances to remain available in the next plan year

- **Post-Termination Spend-Downs.** Employer-sponsors may choose to allow employees who terminate FSA participation mid-year in 2020 or 2021 to continue to receive reimbursements from unused benefit amounts through the end of the plan year in which participation ceases. The Notice clarifies that employers can limit the available amounts under the FSA to unused amounts already contributed by the employee (as opposed to the full annual election amount).
- **Mid-Year Election Changes.** While employer-sponsors may permit employees to make mid-year election changes under an FSA absent a qualifying event, the Notice reminds employers that all election changes are on a prospective, not retroactive, basis. However, where an employee elects to begin FSA participation mid-year, the employer may allow for the reimbursement of expenses incurred prior to the date participation begins, as early as the first day of the plan year.

## Additional Relief for Health Plans

In addition to the FSA relief provided for by the Act, the Notice introduces flexibility measures for group health plan coverage, as well. Specifically, for health coverage elections made under a Sec. 125 Plan, employer-sponsors may permit mid-year election changes absent a qualifying event for plan years ending in 2021. [This relief is identical to the temporary relief the IRS provided for health coverage elections in 2020.](#)

## Employer Action

Because these flexibility provisions are optional, employer-sponsors should consider which provisions – if any – it wishes to incorporate. In addition to the potential advantages these provisions will offer to employees, employers should evaluate their own administrative capabilities and limitations, including any limitations that a Third-Party Administrator may impose.

Where the employer also offers high-deductible health plan coverage to employees, the impact of the carryover and grace period provisions on HSA eligibility should be carefully evaluated. To avoid a negative impact on HSA eligibility, employers will likely wish to implement a Limited Purpose FSA option.

Finally, if an employer chooses to incorporate any of these provisions, it must adopt appropriate plan amendments no later than the last day of the calendar year beginning after the end of the plan year to which the change relates. For example, for a change made to a 2021 calendar year plan, an amendment must be adopted no later than December 31, 2022. For ERISA plans, these amendments will trigger the requirement to distribute a Summary of Material Modification or an updated Summary Plan Description to participants.

## ADDITIONAL RESOURCES

### [IRS Notice 2021-15](#)

[Benefits Bulletin, IRS Provides Temporary Flexibility for Cafeteria Plans, Health FSAs, and DCAPs, May 13, 2020](#)

[Benefits Bulletin, New COVID-19 Relief Bill: Highlights for Employers, December 29, 2020](#)