

Publications

Putting it All Together – Cafeteria Plan and Flexible Spending Account Options in 2020 and 2021

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There has been a whirlwind of new legislation and guidance related to cafeteria plans and flexible spending accounts (FSAs), beginning with the Coronavirus Aid, Relief and Economic Security (CARES) Act in March 2020 through Internal Revenue Service (IRS) guidance issued the end of March 2021. This new legislation and IRS guidance is designed to give employees more flexibility to make election changes and to use FSA funds that otherwise would have to be forfeited. This alert summarizes the guidance over the past year.

OTC DRUGS AND MENSTRUAL CARE PRODUCTS

CARES Act and IRS Notice 2021-15:

- An employer may (but is not required to) amend its cafeteria plan to permit a health flexible spending account (health FSA) to reimburse expenses for over-the-counter (OTC) drugs without a prescription. The amendment may be retroactively effective to include such expenses incurred on or after January 1, 2020.
- Menstrual care products are considered to be medical care under Internal Revenue Code (Code) §213(d). Cafeteria plans probably do not need an amendment to include menstrual care products as a reimbursable expense if the plan incorporates all eligible expenses under Code §213(d) for purposes of reimbursement. This change is applicable for expenses incurred on or after January 1, 2020.
- These expenses are also reimbursable under health reimbursement arrangements (HRAs), health savings accounts (HSAs) and Archer medical savings accounts (Archer MSAs).
- The reimbursement of OTC drugs and menstrual care products is a permanent change to the Code.

Pre-CARES Act:

- Only OTC drugs that were prescribed and insulin were reimbursable expenses.

PERSONAL PROTECTIVE EQUIPMENT

IRS Announcement 2021-7:

- Personal protective equipment, such as masks, hand sanitizer and sanitizing wipes, for the primary purpose of preventing the spread of COVID-19 (COVID-19 PPE) is considered to be medical care under Code §213(d). Cafeteria plans probably do not need an amendment to include COVID-19 PPE as a reimbursable expense if the plan incorporates all eligible expenses under Code §213(d) for purposes of reimbursement. This change is applicable for expenses incurred on or after January 1, 2020.
- These expenses also are eligible to be paid or reimbursed under HRAs, HSAs and Archer MSAs.
- The IRS' position on the reimbursement of COVID-19 PPE expenses would seem to be a temporary position that will no longer be applicable once the pandemic ends.

Pre-IRS Announcement 2021-7:

- Personal protective equipment was not a reimbursable expense.

2020 FSA CHANGES

IRS Notice 2020-29:

- Provided employers with more flexibility for 2020 mid-year election changes under cafeteria plans (including FSAs) as well as permitting the extension of grace periods and carryovers of unused 2019 FSA amounts through the end of 2020. This guidance permitted an employee to revoke an election, make a new election, or decrease/increase an election regarding a health FSA or a dependent care FSA. This relief (which was optional and retroactive to January 1, 2020) was temporary and applied only to the 2020 plan year. If an employer adopted any of this optional relief, a plan amendment will be needed.

Pre-IRS Notice 2020-29:

- Mid-year election changes required a change in status event. No extension of grace period beyond 2½ months after the end of the plan year.

2021 FSA ELECTION CHANGES

Consolidated Appropriations Act, 2021 (CAA) and IRS Notice 2021-15:

- An employer may (but is not required to) permit employees to change health FSA (or limited purpose FSA) and/or dependent care FSA elections without regard to a change in status or life event in plan years ending in 2021 (*g.*, 1/1/2021 through 12/31/2021 for calendar year plans). The employer has discretion regarding how it applies these provisions. This is a temporary change and applies only to the 2021 plan year. If an employer adopts this optional relief, a plan amendment will be needed.

Pre-CAA:

- FSA election changes required a change in status event.

FSA CARRYOVERS – 2020 to 2021 and 2021 to 2022

CAA and IRS Notice 2021-15:

- An employer may (but is not required to) permit employees to carry over their entire unused health FSA (or limited purpose health FSA) and/or dependent care FSA balances from plan year 2020 to 2021 and from plan year 2021 to 2022. These are temporary changes. If an employer adopts this optional relief, a plan amendment will be needed.
- A cafeteria plan cannot have both a grace period and a carryover. However, an employer can switch from one option to the other (or, if it did not previously have either option, add one of the options).
- As was the case pre-CAA, unused amounts may not be refunded to employees.
- If the employer has a HSA-eligible high deductible health plan, care must be taken in designing health FSA carryovers and grace periods so as to preserve employees' eligibility to make HSA contributions. The employer has options regarding how to preserve HSA eligibility.

Pre-CAA:

- Health FSA (and limited purpose FSA) carryovers from 2020 to 2021 would have been limited to \$550 (newly increased from \$500 per IRS Notice 2020-33) and dependent care FSA carryovers would not have been permitted.

FSA GRACE PERIODS – 2020 to 2021 and 2021 to 2022

CAA and IRS Notice 2021-15:

- An employer may (but is not required to) extend a grace period from 2 ½ months beyond the end of the plan year through December 31, 2021 for the use of unused 2020 health FSA (or limited purpose FSA) and/or dependent care FSA balances and through December 31, 2022 for the use of unused 2021 health FSA (or limited purpose health FSA) and/or dependent care FSA balances. These are temporary changes. If an employer adopts this optional relief, a plan amendment will be needed.
- A cafeteria plan cannot have both a grace period and a carryover. However, an employer can switch from one option to the other (or, if it did not previously have either option, add one of the options).
- As was the case pre-CAA, unused amounts may not be refunded to employees.
- If the employer has a HSA-eligible high deductible health plan, care must be taken in designing health FSA carryovers and grace periods so as to preserve employees' eligibility to make HSA contributions. The employer has options regarding how to preserve HSA eligibility.

Pre-CAA:

- The FSA grace period would have been limited to 2½ months (to March 15, 2021 or March 15, 2022).

DEPENDENT CARE FSA REIMBURSEMENT FOR CARE OF 13 YEAR OLD CHILD

CAA and IRS Notice 2021-15:

- An employer may (but is not required to) permit employees to use their dependent care FSAs for the care of a child under the age of 14 in 2020 and 2021. This would be available to an employee who (i) was enrolled in a dependent care FSA in 2020; (ii) has a child who attained age 13 in 2020; and (iii) had an unused 2020 dependent care FSA balance. This is a temporary change. If an employer adopts this optional relief, a plan amendment will be needed.
- This option may have limited utility in that a 13 year old child may not be in child care. The special age limit rule also does not permit an employer to reimburse expenses for a child who is age 14 or older.

Pre-CAA:

- Reimbursement from a dependent care FSA would have been limited to children under the age of 13.

HEALTH FSA SPEND DOWN

CAA and IRS Notice 2021-15:

- An employer may (but is not required to) permit employees who terminate employment in 2021 to spend down the balance of a health FSA (or limited purpose health FSA) through the end of the year (including any grace period), without needing to elect COBRA or pay COBRA premiums. The uniform coverage rule would not apply (meaning a former employee would be limited to accessing his or her year-to-date contributions minus year-to-date reimbursements). This is a temporary change. If an employer adopts this optional relief, a plan amendment will be needed.
- Employees who experience a qualifying event under COBRA must be provided with a COBRA continuation election even if an employer adopts the health FSA spend down option.

Pre-CAA:

- A spend down feature was not previously available for health FSAs. In contrast, a spend down feature has been and continues to be permissible for dependent care FSAs.

2021 DEPENDENT CARE FSA ANNUAL LIMIT INCREASE

American Rescue Plan Act of 2021 (ARP):

- The annual limit for single employees and married employees who file a joint return has increased to \$10,500 and the annual limit for married employees who file a separate return has increased to \$5,250. An employer may (but is not required to) amend its dependent care FSA to permit additional contributions to take advantage of the increased limits. Even if an employer does not amend its dependent care FSA to permit additional contributions, these changes will permit a tax exclusion for amounts carried over and reimbursed in 2021. However, an employee may benefit more from changes made to the dependent care tax credit under ARPA.

- The annual limits will return to the \$5,000 (\$2,500) in 2022 without further action from Congress.

Pre-ARP:

- The annual limit for single employees and married employees who file a joint return was \$5,000 and the annual limit for married employees who file a separate return was \$2,500.

2020 MID-YEAR GROUP HEALTH PLAN ELECTION CHANGES

IRS Notice 2020-29:

- An employer was permitted (but not required to) amend its cafeteria plan to allow the following mid-year changes on a prospective basis during 2020 without requiring a change of status: (i) make a new election for health coverage, if the employee initially declined to elect employer-sponsored health coverage; (ii) revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer (including changing enrollment from self-only coverage to family coverage); and (iii) revoke an existing election for employer-sponsored health coverage, provided that the employee attested in writing that the employee was enrolled, or immediately would enroll, in other health coverage not sponsored by the employer. This relief, which was retroactive to January 1, 2020 was temporary and applied only to the 2020 plan year. If an employer adopted this optional relief, a plan amendment will be needed.

Pre-IRS Notice 2020-29:

- Mid-year election changes required a change in status event.

2021 MID-YEAR GROUP HEALTH PLAN ELECTION CHANGES

IRS Notice 2021-15:

- An employer may (but is not required to) amend its cafeteria plan to allow the following mid-year changes on a prospective basis without regard to a change in status or life event in plan years ending in 2021 (e.g., 1/1/2021 through 12/31/2021 for calendar year plans) to (i) enroll in the employer's health plan, if the employee had initially declined to enroll or (ii) to switch from one health plan option to a different health plan option and/or add eligible family members, if the employee is already enrolled. An employer may permit employees to drop the employer's health plan if – and only if – the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer. The IRS provided a sample attestation form, which employers may rely upon as a safe harbor. This relief is temporary and applies only to the 2021 plan year. If an employer adopts this optional relief, a plan amendment will be needed.
- If you are considering permitting mid-year enrollments or other mid-year changes to health coverage in 2021, check with your insurer or stop loss carrier to get their agreement.

Pre-IRS Notice 2021-15:

- Mid-year election changes required a change in status event.

WHAT STEPS DO EMPLOYERS NEED TO TAKE NOW?

- Consider whether any of the optional changes should be adopted and the impact of adopting such changes to your plan and your employees.
- Discuss any potential changes with third-party administrators, insurers and stop-loss carriers.
- Communicate changes with employees as soon as possible.
- Keep a record of any changes adopted and effective dates for such changes.
- Amend your plans timely. You will need to amend your cafeteria plan document by **December 31, 2021** to reflect any options adopted retroactively effective to January 1, 2020.

Please contact your Vorys attorney if you have questions regarding any of the changes discussed in this alert.