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TO: The Council

FROM: Scott Sinder
Kate Jensen
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RE: IRS Notice 2021-15, Additional Relief for COVID-19 under § 125 Cafeteria Plans

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On February 18, the Internal Revenue Service ("IRS") issued Notice 2021-15, interpreting Section 214 of the Consolidated Appropriations Act, which temporarily gives greater flexibility to employee benefit plans offering health flexible spending arrangements ("FSAs") or dependent care assistance programs ("DCAPs").[1] Among other things, Section 214 and the Notice provides these plans with additional discretion to:

- Temporarily expand carryovers and extend grace periods for health FSAs and DCAPs for 2020 and 2021 plan years, allowing unused benefits remaining to be available in the immediately subsequent plan year;
- Permit employees to make certain prospective mid-year election changes (including to employer-sponsored insurance), without regard to any change in status, for plan years ending in 2021; and
- Allow health FSA participants who stop participating in their plan—whether because of termination or a change in employment status—to continue to receive reimbursements without threatening their COBRA eligibility.

The details of the ***voluntary*** relief provisions for FSAs and DCAPs are detailed further below, along with how they impact and interact with the rules governing COBRA and HSA eligibility. Additionally, the Notice addresses the ongoing option for employers to offer mid-year election flexibility to their employees, including changes in FSA enrollment, but also other health coverage offered by the employer. Employers who opt to implement any of these voluntary measures should be mindful of how they interact and impact employee eligibility for other arrangements/benefits.

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[1] *See* Notice 2021-15, Additional Relief for Coronavirus Disease (COVID-19) under § 125 Cafeteria Plans, (Feb. 28, 2021); Consolidated Appropriations Act 2021, Pub. L. 116-260 (December 27, 2020).

I. Voluntary Expansion of Carryovers and Grace Periods (Optional for Employers)

Under current law, cafeteria plans may permit participants to either carryover unused health FSA funds to the following plan year subject to a carryover limit (i.e., the so-called "carryover rule") or use such unused funds during a grace period of up to 2.5 months immediately following the plan year (i.e., the so-called "grace period rule"). A plan may allow participants to carryover or adopt a grace period, but it may not use both.

In response to COVID-19—and an awareness that "participating employees are more likely to have unused health FSA amounts or dependent care assistance program amounts at the end of 2020 and 2021"—Section 214 of the CAA and the Notice ***allow*** (but do not require) cafeteria plans to temporarily increase employee access to health FSA and DCAP amounts by:

- Expanding carryovers for plan years ending in 2020 and 2021 (i.e., allowing employers to amend their plans and let employees carryover all or part of the unused amounts remaining in a health FSA or DCAP (regardless of whether it exceeds the employer's carryover amount) to the immediate subsequent plan year).
- Extending grace periods for plan years ending in 2020 and 2021 (i.e., permitting employers to offer a grace period of up to 12 months after the end of the plan year for employees to apply unused FSA and DCAP amounts).
- Permitting employers that adopt a grace period to allow employees who cease participation in a plan during calendar years 2020 and 2021 due to termination, change in employment status, or a new election to continue to receive reimbursements from unused benefits or contributions through the end of the plan year in which their participation ceased (including any grace period). Note, however, the limited extension of the grace period for an employee who ceases to be a participant (e.g., because of termination of employment or reduction in hours) will not affect the individual's ability to elect COBRA, despite ongoing access to his/her FSA dollars (i.e., the individual will still be deemed to have experienced a loss of coverage resulting in a qualifying event, and the employer will still be ***required*** to provide a notice of the right to elect COBRA continuation coverage to the individual).

Consistent with current law, however, an employer cannot implement both a carryover and an extended grace period in a single plan year, and a written plan amendment must specify which option is adopted for a given plan year. Moreover, the Notice clarifies that adoption of the expanded carryover or the extended grace periods will not affect COBRA eligibility, determinations, or premiums (e.g., any amounts available to an employee due to the carryover or grace period if an employee ceases coverage under a health FSA may not be considered when determining COBRA premiums).

As noted above, these options—which are available to all cafeteria plans, regardless of whether they currently offer a carryover or grace period—are entirely voluntary and may be further limited by the employer. For example, the Notice clarifies that an employer may:

- Limit the carryover (1) to an amount less than all unused amounts and/or (2) only up to a specified date, not the entire subsequent plan year.
- Choose to adopt a grace period that is less than 12 months.

- With respect to the extension of the grace period for an employee who ceases to be a participant, limit the unused amounts in the health FSA to the amount of salary reduction contributions the employee made during the plan year before participation ceased.
- Subject to applicable nondiscrimination rules, decide to adopt a carryover or grace period for some but not all cafeteria plans.

II. Mid-Year, Prospective Coverage Election Changes (Optional for Employers)

In general, elections regarding qualified benefits (including health FSAs and DCAPs) must be irrevocable and made prior to the first day of the plan year, subject to limited exceptions (e.g., employers may permit revocation if there is a change in status, significant increase in cost of coverage, etc.).

Section 214 and the Notice, however, provide that cafeteria plans may permit employees to make prospective mid-year election changes, without regard to any change in status, for plan years ending in 2021. With respect to health FSA and DCAP contributions, the Notice provides that employers may allow employees to revoke an election, make one or more elections, or increase or decrease an existing election. The Notice further extends this flexibility to employer-sponsored coverage, permitting—but again, not requiring—employers to amend their cafeteria plans to allow employees to:

- Make a new election (if the employee initially declined to elect employer-sponsored coverage).
- Revoke an existing election 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).
- Revoke an existing election, provided that the employee attests in writing that the employee is enrolled (or immediately will enroll) in other health coverage not sponsored by the employer.

An employer that opts to permit such mid-year election changes, however, may limit the relief offered. For instance, an employer may, in its discretion:

- Limit the period during which such election changes may be made (i.e., allow mid-year election changes without a status change up to a certain date in the plan year, but require a status change after that date).
- Limit the number of election changes during the plan year that are not associated with a status change (e.g., allow only one election change in the 2021 plan year without a status change).
- With respect to employer-sponsored coverage, restrict elections to circumstances in which an employee's coverage will be increased or improved as a result of the election (e.g., switching from self-only coverage to family coverage or from a low option plan to a high option plan).
- With respect to health FSAs and DCAPs, prevent mid-year elections from being decreased below amounts already reimbursed or only permit decreases in elections.

Plans are not required to permit these mid-year election changes, and how amounts remaining in health FSAs and DCAPs will be treated for reimbursement purposes will depend on the terms of the plan, including the extent of the relief provided by the employer pursuant to the discussion in Section I.

III. Impact on HSA Eligibility

In general, coverage by a general purpose health FSA (including through a carryover or grace period) disqualifies an otherwise eligible individual from contributing to a health savings account ("HSA") because a general purpose FSA constitutes a health plan that is not a high deductible health plan ("HDHP"). Limited purpose health FSAs and post-deductible health FSAs, on the other hand, are HSA-compatible.

These general rules are unaffected by the guidance. For instance, continued coverage under a general purpose health FSA due to an expanded carryover or extended grace period still renders an employee **ineligible** to contribute to an HSA for as long as s/he has access to that FSA coverage.

The overall election flexibility provided in the Notice could, however, allow more participants to become HSA-eligible mid-year. For instance, employers may amend their plans to:

- Allow employees to make a mid-year election to be covered by a general purpose health FSA for the first part of the year and an HSA-compatible FSA for the second part of the year (recall that HSA eligibility is a month-to-month determination, so you could divide up the year this way).
- On an employee-by-employee basis, permit employees to opt out of extended carryovers or grace periods in plan years ending in 2021 and 2022 to preserve their HSA eligibility.
- Implement a plan design in which employees who elect a HDHP are automatically enrolled in an HSA-compatible health FSA.

While the Notice does not fundamentally alter the FSA/HSA framework, it is possible that employers that amend their FSA plans and/or provide their employees with broad coverage election flexibility could be facing monthly, employee-specific analyses around eligibility, permissible contributions and reimbursements, etc.

IV. Miscellaneous

The Notice provides additional guidance which may be of interest to Council members, including:

- *DCAPS*. Allows reimbursement for dependent care up to age 14 (rather than 13) in cases where an employee's dependent turned 13 in 2020, and the employee had unused funds from 2020.
- *Retroactive Plan Amendment*. Permits plan amendments adopted by employers to be applied retroactively, provided that the plan is operated consistent with the terms of the amendment as of its effective date.

- *Expansion of Permitted Medical Expenses*. Clarifies that—as enacted in the CARES Act—expenses for over-the-counter drugs and menstrual care products (without prescriptions) are qualified medical expenses and reimbursable by health FSAs and other arrangements.

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