



HAYS COMPANIES

IRS Issues Guidance on the DCAP and Health FSA Relief Provided Under the Consolidated Appropriations Act

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Last week the IRS issued Notice 2021-15 (the Notice) (available [here](#)), providing guidance regarding the relief contained in the Consolidated Appropriations Act of 2021 (CAA) for dependent care assistance plans (DCAPs) and health flexible spending accounts (Health FSAs). The Notice contains important clarifications regarding both CAA provisions.

Temporary Relaxed Carryover Rules for DCAP and Health FSAs

The CAA allows employers to permit participants to carryover all unused funds from DCAPs and health FSAs in 2020 and 2021. The Notice contains the following key clarifications regarding these carryovers:

- Carried-over balances do not count against the limit on health FSA contributions for the plan year to which the carryover is made.
- Carried-over DCAP balances do not impact an employer's W-2 reporting. Employers may continue reporting DCAP benefits on an employee's Form W-2 based on the contributions made during the tax year. The Notice seems to suggest that such balances will be counted against the cap on non-taxable dependent care benefits (which is \$5,000 for most taxpayers) in the year in which the funds are used. However, there continues to be some questions about the application of the cap on non-taxable benefits. Customers should consult their tax advisors before adopting this relief concerning their DCAPs. If the relief is adopted, DCAP participants should be advised to consult their tax advisors.
- An employer may adopt this relief even if the DCAP and/or health FSA currently includes the standard 2 ½ month grace period.
- An employer cannot adopt both this relief and the grace period relief described below.
- Employers that adopt this relief may place limits on the carryover. For example, the employer may limit the amount carried over or the time period during which the carried-over funds may be used. It may also restrict the availability of the carryover to only those employees who make contributions to the plan during the new plan year.



- To address HSA eligibility issues created by receiving a carryover under a general-purpose health FSA, the employer may allow participants to opt-out of the carryover, automatically convert the carried-over balance to an HSA-compatible health FSA (e.g., a limited-purpose health FSA), or allow the participants to elect to have the balance carried over to an HSA-compatible health FSA.

Temporary Extension of Claim Periods for DCAP and Health FSAs

The CAA allows employers to provide an extended claims period of up to 12 months under their DCAP and health FSA account after the end of the 2020 and 2021 plan years. The Notice contains the following key clarifications regarding these extended claims periods:

- Unused health FSA balances used during the extended claims period do not count against the limit on health FSA contributions for the plan year they are used.
- The availability of the extended claims period does not impact an employer's W-2 reporting. Employers may continue reporting DCAP benefits on an employee's Form W-2 based on the contributions made during the tax year. The Notice seems to suggest that such balances will be counted against the cap on non-taxable dependent care benefits (which is \$5,000 for most taxpayers) in the year in which the funds are used. However, there continues to be some question about the application of the cap on non-taxable benefits. Customers should consult their tax advisors before adopting this relief with respect to their DCAPs and, if the relief is adopted, DCAP participants should be advised to consult their tax advisors as well.
- An employer may adopt this relief regardless of whether the DCAP or health FSA currently includes a grace period.
- An employer may adopt this relief even if the health FSA currently includes the standard carryover feature.
- An employer cannot adopt both this relief and the carryover relief described above.
- Employers that adopt this relief may limit the length of the extended claims period to something less than 12 months.
- To address HSA eligibility issues created by having access to the extended claims period under a general-purpose health FSA, the employer may allow participants to opt-out of the extended claims period, may automatically convert the carried over balance to an HSA-compatible health FSA, or may allow participants to elect to begin participating in an HSA-compatible health FSA during the extended claims period.



Temporary Relief for Post-Termination Reimbursements from Health FSAs

The CAA allows employers to permit terminated employees to use their unused health FSA benefits or contributions (i.e., spend down the unused balance) to receive reimbursements for qualifying expenses incurred through the end of the plan year in which they were terminated. The Notice contains the following key clarifications regarding this spend down provision:

- Despite the uniform coverage rule, employers adopting this relief may limit the benefit available to the terminated participant to the amount of unused salary reduction contributions made to the health FSA.
- Employers adopting this relief who are subject to COBRA must still comply with COBRA to the extent the termination (or reduction in hours) causes a loss of coverage under the health FSA. If the employer restricts the benefit available to the amount of unused contributions, there will be a loss of coverage.
- Employers adopting this relief may limit the time period during which terminated participants may spend down their health FSAs to something less than the remainder of the plan year.

Temporary Rule Increasing the Maximum Age of Eligible Dependents for Use of DCAP Funds

The CAA allows DCAPs to permit reimbursement of otherwise eligible dependent care expenses for children who are 13 years old in certain situations. The Notice contains the following key clarifications regarding this provision:

- An employer adopting this relief is not required to adopt the carryover or extended claims period relief. However, in that case, this relief will apply only to the plan year with respect to which the end of the regular enrollment period was on or before January 31, 2020 (e.g., the 2020 plan year starting on 1/1/20). The DCAP may reimburse expenses incurred with respect to 13-year-old children only during that plan year (and only if the child attained age 13 during that plan year).
- If the employer also adopts the carryover or extended claims period relief, then the DCAP can also reimburse expenses incurred with respect to 13-year-old children during the subsequent plan year (e.g., the 2021 plan year). The reimbursements can be provided only from the unused account balance remaining from the 2020 plan year (i.e., the plan year with respect to which the end of the regular enrollment period was on or before January 31, 2020).
- The relief does not authorize the reimbursement of expenses incurred with respect to 14-year-old children in either plan year.

Note: In prior communications we indicated that the CAA authorized DCAPs to temporarily reimburse eligible expenses for children “up to age 14.” Our use of the phrase “up to age 14” was intended to mean that DCAPs can temporarily reimburse expenses of 13-year-old children until they attain age 14. This was confirmed in Notice 2021-15.



Temporary Flexibility Regarding Mid-Year Election Changes to DCAP, Health FSA, and Group Health Plan Elections

The CAA allows employers to permit DCAP and health FSA participants to make prospective changes to their elections for plan years ending in 2021 without regard to any change in status. The Notice contains the following key clarifications regarding this election change relief:

- Employers that adopt this relief may place limits on the election changes allowed. For example, the employer may authorize the election changes only during a certain time period, limit the number of changes, limit the types of changes allowed, etc.
- Employers that adopt this relief may allow amounts contributed to the DCAP or health FSA after implementing the revised election (including brand new elections) to be used for eligible expenses incurred during the plan year prior to the effective date of the election change.
- This relief does not authorize refunds of amounts contributed to the DCAP or health FSA prior to the election change request.
- If a health FSA or DCAP election is revoked (i.e., no additional contributions will be made), the Notice provides three options for any unused balance at the time the election change is implemented:
 - The plan may provide that such amounts remain available to reimburse expenses incurred during the remainder of the plan year.
 - The plan may provide that such amounts are available to reimburse only eligible expenses incurred before the revocation takes effect.
 - The plan may provide that such amounts are forfeited.

Under the second and third options, health FSA participants are immediately eligible for HSA contributions.

- Employers may amend their plans to allow participants to make a mid-year election to be covered by a general-purpose health FSA for part of the year and an HSA-compatible health FSA (e.g., limited-purpose health FSA) for part of the year.
- If a participant elects to change from an HSA-compatible health FSA to a general-purpose health FSA, only those expenses allowed by the HSA-compatible health FSA and incurred during the months in which the employee was

covered by the HSA-compatible health FSA may be reimbursed by that health FSA. Unused amounts in the HSA-compatible health FSA may be added to the -general-purpose health FSA after the election change. However, the general-purpose health FSA may reimburse only allowable medical care expenses incurred after the change in coverage.

- If a participant elects to change from a general-purpose health FSA to an HSA-compatible health FSA, any eligible medical care expenses incurred during the months before the change in coverage may be reimbursed by the general purpose health FSA. Unused amounts in the general-purpose health FSA may be added to the HSA-compatible health FSA after the election change. However, only expenses both allowed by the HSA-compatible health FSA and incurred during months after the change in coverage may be reimbursed by the HSA-compatible health FSA.
- The Notice expands the election change relief to apply to elections to pay group health plan premiums. Under the Notice, an employer may amend its Section 125 cafeteria plan to permit prospective changes to group health plan elections during plan years ending in 2021.
 - Group health plans include medical, dental, and vision plans.
 - The changes allowed include (1) making a new election for employer-sponsored health coverage if the employee initially declined to elect employer-sponsored health coverage; (2) revoking an existing election for employer-sponsored health coverage and making a new election to enroll in different health coverage sponsored by the same employer; and (3) revoking an existing election for employer-sponsored health coverage, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other comparable health coverage not sponsored by the employer. The Notice contains a sample attestation.
- To the extent an employer wishes to allow these election changes, it likely will need to amend its group health plans and obtain the consent of the insurance carrier or stop loss carrier.



Next Steps

If, in light of the clarifications contained in the Notice, a plan sponsor would like to make one or more of these changes, it should contact its health FSA and DCAP administrator and benefit administration vendor(s) to discuss implementation of the changes. Plan sponsors will need to develop a plan to communicate the changes to applicable employees and adopt the required plan amendments in a timely manner.

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