

Stimulus Bill Adds Flexibility to Flexible Spending Accounts

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On December 27, 2020, President Trump signed into effect the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (the Act) as part of the COVID-19 stimulus bill. The Act provides for some welcome relief for health and dependent care flexible spending accounts (FSAs) in response to the effects of COVID-19.

FSAs allow employees to make pretax contributions through a “section 125 cafeteria plan” to pay for qualifying medical and child care expenses. In general, elections for benefits provided through a cafeteria plan are irrevocable for a plan year, but certain prospective election changes can be made as a result of a change in status or change in the cost of coverage, among other things. Health FSAs may, but are not required to, allow participants to (i) carry over a limited amount of unspent contributions at the end of a plan year to use toward eligible medical expenses incurred in the subsequent year, or (ii) use unspent amounts during a grace period of up to 2-1/2 months in the following year. Dependent care FSAs may provide for a grace period, but cannot permit carryover of unused funds.

As a result of working from home, and of school, camp, and day care closures, individuals may have unused amounts in their dependent care FSAs. Also, because of layoffs and furloughs, employees may have built up health FSA account balances during 2020 that they have been unable to draw upon. While the IRS allowed limited relief earlier this year by allowing individuals to stop elections on a prospective basis, many individuals still have unused amounts remaining in their FSAs that are subject to forfeiture if not used.

The Act expands on existing rules related to FSAs by allowing employers to apply one or

more of the following temporary relief measures to help employees avoid forfeiture of unused FSA contributions:

- For plan years ending in 2020 or 2021, a cafeteria plan may allow unused health and dependent care FSA amounts to either be carried over for use in the following year or used during an extended 12-month grace period. Normal restrictions that limit carryovers to \$550, and the grace period to 2-1/2 months, will not apply.
- For plan years ending in 2021, an employee may be permitted to make a prospective change at any time for a health or dependent care FSA.
- A cafeteria plan may permit employees who cease making contributions to a health FSA mid-year in 2020 or 2021 to continue to use their health FSA balances to pay for expenses incurred through the end of the plan year, including expenses incurred during any grace period.
- Dependent care FSAs typically allow for reimbursement of child care costs for children who are under the age of 13. If the FSA is elected for a plan year with an enrollment period on or before January 31, 2020, employers may allow for reimbursement of such costs for dependent children up to age 14, and allow any unused dependent care FSA funds from that plan year to be used by the employee in the following plan year.

None of these changes are mandatory. However, they do offer an opportunity for employers to provide relief to employees and former employees who made contributions that they are unable to access and would otherwise forfeit. Any amendments to a cafeteria or FSA plan to

reflect these changes must be made by the end of the plan year after the change is effective. The amendments can be retroactive, but plan operation must be consistent with the terms of the amendments from the effective date through the date of adoption.

Employers implementing these changes should be mindful of the fact that an employee who participates in an FSA generally cannot also participate in a health savings account (HSA). Accordingly, employers should consider whether implementing any of these relief provisions will impact the ability of employees to participate in an HSA for 2021 or 2022.

Employers should review the guidance and consider, in consultation with advisors, whether to implement any or all of the permitted changes. Attorneys in Lowenstein Sandler's Employee Benefits and Executive Compensation Group are available to answer any questions you may have about these new rules.

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