

IRS Clarifies Extended Cafeteria Plan Relief

Much of the [previous relief](#) that had been granted to [cafeteria plans](#) during the COVID-19 pandemic was set to expire after 2020. In late December, though, Congress passed the Consolidated Appropriations Act, 2021 (CAA), which included additional cafeteria plan relief but left many open questions regarding how the relief provisions should be implemented and administered. Earlier this month, the Internal Revenue Service (IRS) issued [Notice 2021-15](#) (2021 IRS Notice) to provide much needed clarification on the CAA's cafeteria plan provisions. In this update, we discuss some of the key takeaways from the IRS's clarifying guidance.

As with prior cafeteria plan relief issued in 2020, the changes provided in the CAA are optional, but plan sponsors that wish to implement the permitted changes must timely adopt a formal plan amendment to the cafeteria plan (including any other governing document for the flexible spending account benefits) to do so.

FSA Carryovers

Under the CAA, a plan sponsor is permitted to amend its cafeteria plan to allow for a carryover of all (or some) of the unused amounts remaining in a Health Flexible Spending Account (Health FSA) or a Dependent Care Assistance Program (DCAP) as of the end of the plan year ending in 2020 and in 2021. Per the 2021 IRS Notice, the plan can be amended to provide for this CAA carryover regardless of whether plan terms currently provide for a carryover or a grace period (or neither) for the benefit. Additionally, the plan sponsor has discretion to permit individual participants to opt-out of such a carryover, including, for example, to preserve Health Savings Account (HSA) eligibility.

The 2021 IRS Notice confirms that the CAA provides an exception, for only the 2020 and 2021 plan years, from the general rule that prohibits a DCAP from offering a carryover feature.

Extended Grace Periods

For a cafeteria plan with a Health FSA or DCAP grace period ending in 2020 or 2021, the CAA permits a plan sponsor to amend the plan to extend that grace period for up to 12 months after the end of the plan year (or a shorter period, if desired). Per the IRS 2021 Notice, the extension of time to incur claims pursuant to the CAA is available regardless of whether the plan terms currently provide for a carryover or a grace period (or neither) for the benefit. The plan sponsor similarly has discretion to permit individual participants to opt-out of the extension.

A plan is not permitted to offer both a carryover and a grace period in the same plan year for the same benefit. However, a plan that provided for a grace period in a prior plan year may be amended to permit the unlimited carryover for a subsequent plan year. Alternatively, a plan that permitted a carryover in the prior plan year may be amended to allow for a grace period for the subsequent plan year. For example, Plan Sponsor A offered a grace period in plan year 2020. To take advantage of the unlimited carryover relief under the CAA, the plan sponsor is permitted to amend its plan to offer an unlimited carryover for plan year 2021, and then later amend the plan to offer a grace period again in a later year. It is generally expected that the CAA relief granted for

carryovers and grace periods will have a similar effect of extending the period for incurring and submitting claims.

Also, consistent with the general rule for Health FSA carryovers outside of the COVID context, unused amounts available from a prior plan year, due to either a carryover or an extended grace period, are not included for purposes of the annual contribution or exclusion limit for the Health FSA or DCAP in the subsequent plan year.

Health FSA Spend-Down

Under the CAA, a plan sponsor is permitted to amend its Health FSA terms to provide a "spend-down" to employees who cease to be a participant in calendar years 2020 or 2021, so they could continue to receive reimbursements through the end of the plan year in which they ceased to participate (including any applicable grace period). The plan sponsor has discretion to make this spend-down option available to an employee who ceased to participate due to termination of employment, loss of eligibility, and/or revocation of election of the benefit.

The 2021 IRS Notice confirmed that this spend-down can be limited to unused amounts that were deducted from the employee's salary from the start of the plan year to the date that they ceased to participate. Also, the CAA spend-down provision does not impact the plan sponsor's responsibility to offer COBRA continuation coverage, although the plan sponsor may require a terminated employee to elect COBRA coverage in order to use the spend-down.

Dependent Care Eligibility

Participants who elected DCAP coverage on or before January 31, 2020, have an unused benefit amount for calendar year 2020, and have a child who reached age 13 in 2020, are permitted to treat that child as an eligible dependent until the child reaches age 14 for purposes of using the unused DCAP benefits. This relief is separate from the CAA's permitted carryover and grace period extensions.

Midyear Election Changes

For plan years ending in 2021, plan sponsors are permitted, but not required, to amend their plans to allow employees to make the following midyear election changes:

- Enroll in healthcare coverage prospectively on a pretax basis
- Change an election midyear and switch on a prospective basis to a different health plan option (or a different coverage tier)
- Prospectively revoke a healthcare election midyear
- Prospectively change elections to a Health FSA or DCAP to
 - Newly elect a Health FSA or DCAP
 - Revoke a Health FSA or DCAP election for all additional contributions remaining in the calendar year
 - Otherwise increase or decrease a Health FSA or DCAP

The 2021 IRS Notice confirmed that plan sponsors may allow for Health FSA or DCAP reimbursements for expenses incurred at any time in 2021, including prior to the date of an election change. The IRS also clarified that "healthcare coverage" for purposes of these permitted midyear election changes would include dental and

vision coverage in addition to medical coverage. Additionally, the 2021 IRS Notice confirmed that the CAA relief includes permitting a plan to be amended to let an employee make a midyear election to effectively switch from a general purpose Health FSA to a limited-purpose (HSA-compatible) Health FSA to avoid HSA eligibility issues for the remainder of the year.

Retroactive Plan Amendments for Certain Relief

As with the previous relief granted in 2020, the CAA and the 2021 IRS Notice provide that a plan sponsor which chooses to implement one or more of these optional changes must adopt a formal plan amendment by the last day of the first calendar year beginning after the end of the plan year of the amendment's effective date. Thus, for changes implemented for a plan year ending in 2020, an amendment must be adopted and effective by December 31, 2021.

The 2021 IRS Notice also permits plan sponsors to adopt a plan amendment retroactive to January 1, 2020, to the extent necessary to allow for the reimbursement of expenses incurred for menstrual care products and over-the-counter drugs without a prescription, as required by the CARES Act for Health FSAs, Health Reimbursement Arrangements, HSAs, and Archer Medical Savings Accounts.

Plan sponsors should consult with their internal and external administrators prior to implementing any amendment. Plan sponsors should also consult with legal counsel for assistance drafting any necessary plan amendment and participant notices, and for advice regarding other implementation considerations.

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