The rules have changed for health care FSAs and DCAPs

Helping employees access the full value of their benefits in light of COVID-19

During the pandemic, your employees may have experienced restricted access to medical care or been forced to delay elective medical procedures.

Their children have been at home, with dependent care centers closed. Many people are working from home instead of commuting to an office. These realities can reduce the value of calendar-year-plan health care Flexible Spending Accounts (FSAs) and Dependent Care Assistance Plans (DCAPs).

In response and to help people receive the full value of their elections, the IRS loosened some of the rules governing these benefits. The IRS clearly states that making any of these changes is entirely up to the discretion of the employer. To help employers who choose to adopt these changes, we've created this guide to document the ins and outs of implementation.

Health care FSAs and DCAPs are “use it or lose it” plans, meaning any funds remaining in these accounts at the end of the plan year are forfeited.

Typically, a runout period is implemented through the first quarter following the plan year, which allows employees to submit claims incurred in the prior year against the previous year’s funds. In some cases, an employer might allow a grace period of an additional 2.5 months to incur health care and dependent care expenses, or allow a health care FSA to carryover amounts of up to $500 to flow into the next year’s plan.

In any case, employees are locked into the amount they elected when they enrolled, with no midyear changes allowed — unless there’s a change in family status (i.e., birth, divorce, marriage or death).

The IRS recently changed the rules governing these accounts

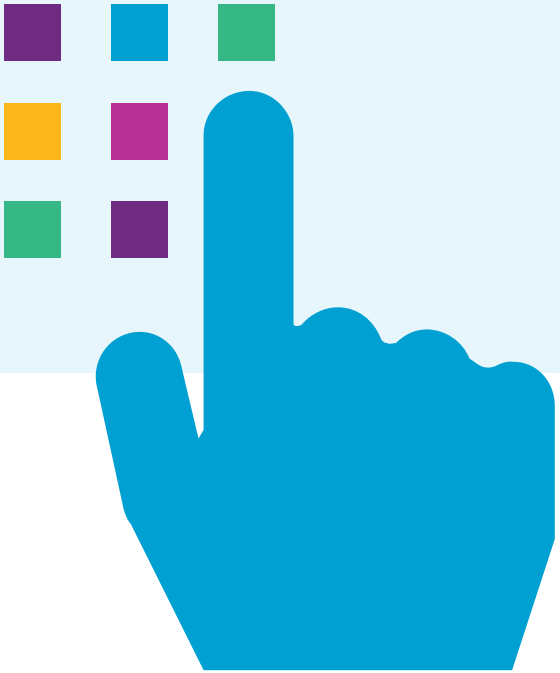
due to the impact of COVID-19 on people’s ability to use their FSA and DCAP funds. These changes address:

- Midyear elections
- Claim/grace periods
- Carryover amount

Midyear elections

For calendar year 2020, employers *may permit* employees who have been making salary reduction contributions to an FSA or DCAP to make midyear election changes. They can:

- Revoke an existing election, ceasing contributions to the plan
- Make a new election, if they originally chose not to participate
- Increase/decrease the amount of an existing election



Employers are permitted to limit midyear elections to amounts no less than amounts already contributed and/or reimbursed in 2020. In other words, an employee can't reduce his or her *annual* election amount to $0 if the employee already had contributions and been reimbursed $500. But if the original election was $1,000 and it now looks like the employee will only spend $500, he or she can reduce the election to $500.

Extended claim periods

For calendar year 2019 health care FSAs and DCAPs, the grace period would typically have ended on March 15, 2020. The IRS now allows employers to extend the grace period until December 31, 2020. Employers can choose not to extend the grace period, or they can choose an earlier date for closing the grace period if they so wish.

If the employer chooses to adopt these changes, unused amounts in health care FSAs and DCAPs, as of the end of the grace period for plan year 2019, can be reimbursed until December 31, 2020.

Even if an employer chooses not to extend the grace period, the IRS has mandated that the claim filing period for health care FSAs (and HRAs) be tolled until 60 days after the end of the declared national emergency. This tolling also applies to appeals of denied claims.

Extended claim periods and Health Savings Accounts

There are limits on HSA contributions for individuals who had unused amounts at the end of the 2019 plan year with a grace period ending in 2020. If their plan gives an extended grace period to incur expenses under their FSA, they may not also contribute to an HSA during the extended period. HSA-compatible health care FSAs, such as a limited-purpose or post-deductible health care FSA, are an exception to this rule.

Health Care FSA carryover amount increase

The health care FSA carryover amount, previously limited to a maximum of $500, may be increased to a maximum of $550. Note that increasing the FSA carryover amount is not related to the COVID-19 pandemic. This change can be implemented regardless of the pandemic and will allow employees to carryover additional funds that would otherwise have been forfeited if not used. The increased carryover amount can be implemented from plan year 2020 into 2021 or it can be implemented from plan year 2021 into 2022. If the preference is to implement from plan year 2020 into 2021, please be sure to update your summary plan descriptions (SPD) to reflect this update and consider a communication strategy to your employees.

Implications for employees and employers

Employers can choose not to adopt any of these changes; they are discretionary. They can also pick and choose the changes they want to make, set the period during which changes are in force, and limit the number of times employees can make a change.

Employers who choose to implement these changes need to understand how their claim administrator is managing extensions of grace period and runout, and communicate the changes to their employees. Employers will also need to reflect this change in a summary of material modifications or SPD and monitor to ensure system changes are implemented. All changes must be communicated to employees as soon as possible after decisions are made. Formal written amendments must be completed by December 31, 2021.

For employees, these changes can reduce or erase the negative impact of COVID-19 on the value of their benefits. This added flexibility for using funds in these accounts can decrease amounts that would have otherwise been forfeited.

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