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COVID-19 Relief for Employees Who Participate in Flexible Spending Accounts

The IRS has issued guidance that expands employees' access to flexible spending account funds in light of the COVID-19 pandemic. The guidance, Notice 2021-15, clarifies in detail the provisions of §214 of the Taxpayer Certainty and Disaster Relief Act of 2020 (Dec. 27, 2020) (TCDDRA) which expands employees' access to health and dependent care FSAs, by tweaking the "use it or lose it rule" and the interplay of the "carryover" and "grace period" rules.

The centerpiece of TCDDRA and Notice 2021-15 is to combine the grace period and carryover rules. Conceptually there is no distinction between the grace period and carryover for PYs 2020 and 2021 PYs. In order to avoid confusion, the IRS refers to the period as the "temporary extension period."

An employer has the discretion to adopt all, some or none of the opportunities presented by TCDDRA and Notice 2021-15. Cafeteria plans must be amended to reflect the employer's choices by the end of the first plan year following the plan year in which the changes are effective. This could be as early as Dec. 31, 2021.

The opportunities provided by TCDDRA and Notice 2021-15 are temporary. Unless extended by Congress, they will expire mostly by the end of PY 2022 and completely by the end of PY 2023.

The following chart summarizes TCDDRA and Notice 2021-15.

ISSUE	PRE-COVID 19	TCDDRA and Notice 2021-15
Carryover for health FSA amounts. ¹	Permitted subject to "carryover limit". The carryover limit is \$550 for 2021.	<ul style="list-style-type: none"> All unused amounts as of the end of PY² 2020 may be carried over to PY 2021. All unused amounts as of the end of PY 2021 may be carried over to PY 2022.
THE CARRYOVER SHOULD ONLY BE ALLOWED FOR AN EMPLOYEE (OR THE EMPLOYEE SHOULD BE PERMITTED TO OPT-OUT) WHO PARTICIPATES IN A HDHP/HSA FOR THE SUBSEQUENT PY IF THE FSA IS CONVERTED TO AN "HSA-COMPATIBLE FSA."		
Carryover for dependent care FSA amounts.	Not permitted.	<ul style="list-style-type: none"> Unused amounts as of the end of PY 2020 may be carried over to PY 2021. Unused amounts as of the end of PY 2021 may be carried over to PY 2022.
Grace periods³ for health FSA.	Limited to first 2-1/2 months of subsequent PY.	<ul style="list-style-type: none"> Grace period for PY 2020 may be up to 12 months after end of PY 2020. Grace period for PY 2021 may be up to 12 months after end of PY 2021.

ISSUE	PRE-COVID 19	TCDRA and Notice 2021-15
Grace periods for dependent care FSA.	Limited to first 2-1/2 months of subsequent PY.	<ul style="list-style-type: none"> • Grace period for PY 2020 may be up to 12 months after end of PY 2021. • Grace period for PY 2021 may be up to 12 months after end of PY 2021.
Post-termination reimbursements from Health FSAs.		<ul style="list-style-type: none"> • An employee who ceases participation in the plan in PY 2020 may continue to use amounts credited to the health FSA through the end of PY 2020 (plus any grace period for PY 2020). • An employee who ceases participation in the plan in PY 2021 may continue to use amounts credited to the health FSA through the end of PY 2021. (plus any grace period for PY 2021).
THE CARRYOVER SHOULD ONLY BE ALLOWED FOR AN EMPLOYEE (OR THE EMPLOYEE SHOULD BE PERMITTED TO OPT-OUT) WHO PARTICIPATES IN A HDHP/HSA FOR THE SUBSEQUENT PY IF THE FSA IS CONVERTED TO AN “HSA-COMPATIBLE FSA.”		
“Temporary extension period”/ Coordination of grace periods, carryovers and COBRA.	A plan may not provide for both a grace period and a carryover .	<p>The grace period and carryover concepts have essentially been combined for PYs 2020 and 2021 into a new concept called the “temporary extension period.”</p> <p>The extension of health FSA eligibility under TCDRA and Notice 2021-15 does not change the general applicability of COBRA.</p>
Mid-year changes of FSA contribution amounts.	Not permitted.	Employees may make prospective changes to the amount of employee contributions to health and dependent care FSAs during PY 2021 for PY 2021.
Mid-year changes of the character of HSA between general-purpose FSA and HSA-compatible FSA.	Not permitted.	Permitted while temporary extension period in effect.
Age limit for Dependent Care Assistance FSAs.	Age 12.	Funds in dependent care assistance accounts may be used for dependents younger than age 14 if the dependent attained age 13 during the COVID-19 pandemic.

¹ “Carryover”, a noun, means an amount that is unused at the end of a PY may be used (i.e., “carried over,” a verb) during the entire subsequent PY for expenses incurred in the subsequent PY. “Carryovers” are subject to a “carryover limit.”

² PY = Plan Year.

³ “Grace period” = the period during a PY when amounts that were not used as of the end of the previous PY may be used to reimburse expenses incurred during the grace period. The “grace period is limited to the first 2-1/2 months of the PY. The only limit on the amount that may be reimbursed during the grace period is whatever was left in the employee’s account at the end of the previous PY.

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