

# IRS Clarifies Relief for FSA Carry-Overs

Employers may allow participants to carry over unused amounts into 2021 and 2022

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**E**mployers can now offer employees participating in health flexible spending accounts (FSAs) and dependent care FSAs greater flexibility for rolling over unused funds through 2022, under new IRS guidance.

IRS Notice 2021-15 (<https://www.irs.gov/pub/irs-drop/n-21-15.pdf>), issued Feb. 18, addresses how to apply the FSA relief provisions in the Taxpayer Certainty and Disaster Relief Act, which was incorporated into the Consolidated Appropriations Act (CAA) signed into law near the end of 2020.

"As a result of COVID-19, participating employees are more likely to have unused health FSA or dependent care [FSA] amounts at the end of 2020 and 2021," the IRS announcement said.

"The IRS was very responsive to the benefits community in providing this guidance in a timely fashion," said William Sweetnam, legislative and technical director at the Employers Council on Flexible Compensation, which represents sponsors of account-based benefits plans.

"The COVID-19-related relief that Congress provided in the Consolidated Appropriations Act, 2020, addressed many of the problems that individuals who contributed to health FSAs or dependent care assistance FSAs were facing, since the pandemic limited opportunities to spend the funds they contributed for their own health care or to pay expenses to care for dependents."

Employers that want to provide this relief "must make a number of decisions to determine what changes to their FSA plans are needed," Sweetnam said. "Notice 2021-15 provides details on how these relief provisions will operate."

Feedback

### Reviewing FSAs Basics

In 2021, employees can contribute \$2,750 to a health FSA ([www.shrm.org/resourcesandtools/hr-topics/benefits/pages/2021-fsa-contribution-cap-and-other-colas.aspx](http://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/2021-fsa-contribution-cap-and-other-colas.aspx)), including to a limited-purpose FSA restricted to dental and vision care services, which can be used in tandem with a health savings account (HSA).

The dependent care FSA maximum ([www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/2020-FSA-Contribution-Cap-Rises-to-2750.aspx#dfsa](http://www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/2020-FSA-Contribution-Cap-Rises-to-2750.aspx#dfsa)), which is set by statute and not adjusted annually for inflation, is \$5,000 a year for individuals or married couples filing jointly, or \$2,500 for a married person filing separately, subject to earned income limits.

Typically, health or dependent care FSA funds that are not spent by the employee within the plan year can include a two-and-a-half-month grace period ([www.shrm.org/resourcesandtools/hr-topics/benefits/pages/fsa-grace-period-reminder.aspx](http://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/fsa-grace-period-reminder.aspx)) to spend down remaining FSA funds, if employees are enrolled in FSAs that have adopted the grace period option.

Health FSAs have an additional option of allowing participants to roll over up to \$550 of unused funds at the end of the plan year and still contribute up to the maximum in the next plan year. Health FSA plans can elect either the carry-over or grace period option but not both.

*[SHRM members-only HR Q&A: What options does an employer have with unused FSA funds? ([www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/cms\\_018488.aspx](http://www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/cms_018488.aspx))]*

Feedback

### What's Changing

Under IRS guidance issued in May 2020 ([www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/irs-allows-mid-year-enrollment-and-election-changes-for-health-plans-and-fsas-coronavirus.aspx](http://www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/irs-allows-mid-year-enrollment-and-election-changes-for-health-plans-and-fsas-coronavirus.aspx)), plan sponsors could allow health and dependent care FSA participants to make midyear contribution changes and increased the carry-over limit permitted for health FSAs through the end of 2020. The CAA extended this relief, for instance by allowing for midyear health and dependent care FSA election changes for plan years ending in 2021 without the need for a qualifying event, such as marriage, divorce, or the birth or adoption of a child.

Under the CAA, health and dependent care FSAs also may be amended to give participants a grace period of up to 12 months following the end of plan years ending in 2020 or 2021. Notice 2021-15 clarifies the CAA's relief, specifically with regards to plan rollover amounts. The guidance addresses how employers can:

- Allow participants in health care or dependent care FSAs to carry over unused balances from a plan year ending in 2020 to a plan year ending in 2021, and to carry over unused balances from a plan year ending in 2021 to a plan year ending in 2022. An employer can choose to provide either, or neither, of these carry-over extensions.
- Extend to 12 months the grace period for spending unused FSA funds for plan years ending in 2020 or 2021.
- Allow employees who stopped participating in a health FSA plan during 2020 or 2021 to continue to be reimbursed from unused balances through the end of the plan year in which their participation ended, including any extended grace periods.

"The CAA's accommodations blur the lines between a grace period and carry-over (<https://www.lockton.com/insights/post/irs-clarifies-aspects-of-recent-fsa-and-cafeteria-plan-accommodations>), as the law allows unlimited carry-overs (more than just \$550) and up to 12-month grace periods," wrote Mark Holloway, senior vice president and director of compliance services at Lockton Companies, a benefits broker and services firm.

Notice 2021-15 also clarifies that employers may extend the dependent care FSA claims period for a dependent who "ages out" by turning 13 years old during the COVID-19 public health emergency. The limiting age remains at 14 for the 2021 plan year, but this relief only applies to dependent care FSA funds that remained unspent at the end of the 2020 plan year.

### Factors to Consider

The decision to adjust any of these FSA limits is at the discretion of employers that sponsor FSA plans.

March 15 marks the end of the two-and-a-half-month grace period to spend down remaining FSA funds, for enrollees in FSAs that have adopted the grace period option. "As the end of the grace period and claims filing deadlines for 2020 calendar year plans are approaching, it is important that employers act quickly," said Kim Tippens, senior director for benefits accounts at consultancy Willis Towers Watson. "Ideally, decisions should be made at least several weeks before these deadlines to allow time for participant communications and system updates," she said.

She advised FSA plan sponsors to speak with their third-party administrator "to understand how the changes can be administratively supported."

Christine M. Zinter, an attorney at Benefits Law NW in Vancouver, Wash., pointed out a consideration for plan sponsors. "In practice, employers who rely on some forfeitures to help defray the cost of the plan may see less forfeit money if terminated employees can submit claims throughout the plan year," she noted.

Zinter raised another point regarding employers that might adopt one of the FSA carry-over provisions without also allowing employees to adjust their FSA contribution elections. Because most employers have already processed employees' FSA contribution elections for 2021 calendar-year plans, "if an employer now decides to choose a rollover or extended grace period for the expired 2020 plan year but does not also allow midyear election changes in the 2021 plan year, some employees' budgets will be thrown off," she said.

### Questions to Ask

When deciding which of the relief provisions to adopt, Holloway recommended that employers ask themselves questions such as:

- **Are employees' FSA balances likely to be larger than normal due to the COVID-19 pandemic?** If not, are employees likely to be worse off if the employer doesn't choose to take on the administrative hassles related to the accommodations?
- **Does the health FSA currently have a grace period or carry-over?** If so, should the employer extend the grace period to up to 12 months or remove the dollar cap from the carry-over? If the FSA has neither a grace period nor carry-over feature, should the employer add one of up to 12 months? In either case, the amendment should be adopted by the end of the plan year ending in 2021.
- **Does the dependent care FSA currently offer a grace period?** If so, should the employer extend it to up to 12 months? If it doesn't, should the employer add a grace period of up to 12 months, or a carry-over feature of up to 12 months? Here, again, amendments should be adopted by the end of the plan year ending in 2021.

"If the leftover dependent care FSA balances dwarf the health FSA balances, the employer might choose, for example, to extend the dependent care FSA grace period or add a carry-over, but not do so for the health FSA," Holloway noted.

### FSA Relief Affects HSA Eligibility

Employees who can continue to spend remaining FSA funds thanks to an extended grace period would be ineligible to contribute to an HSA until the month following the end the grace period, even if they enrolled in an HSA-compatible high-deductible health plan at the start of the year.

Notice 2021-15, however, offers several ways that plan sponsors can adopt health FSA fund-carry-over relief without restricting an employee's eligibility to contribute to an HSA, such as:

- Automatically treating the leftover health FSA amount as available only under a limited purpose FSA with funds accessible only for dental and vision care.
- Allowing employees to waive any leftover balance.
- Limiting the grace period or carry-over window to less than 12 months, thereby allowing the employee to contribute the full, annual HSA contribution under a rule allowing them to do so if they are eligible to make HSA contributions on Dec. 1 of the plan year.

"All of these options add administrative burden to employers (<https://graydon.law/how-to-provide-relief-to-your-fsa-participants-without-impacting-their-hsa-eligibility/>)," blogged Lyndsey Barnett, an attorney with Cincinnati-based Graydon.

"If you are considering adding or expanding a carry-over or grace period provision, we recommend first reviewing your 2020 health FSA balances to determine if there are that many participants that will even benefit from the relief."

Feedback

#### Related SHRM Articles:

Top Considerations for Adopting FSA Funding Relief ([www.shrm.org/resourcesandtools/hr-topics/benefits/pages/top-considerations-for-adopting-fsa-funding-relief.aspx](http://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/top-considerations-for-adopting-fsa-funding-relief.aspx)), *SHRM Online*, January 2021

Appropriations Act Permits Midyear FSA Elections, Unlimited Carry-Over Amounts Through 2021 ([www.shrm.org/ResourcesAndTools/hr-topics/benefits/pages/appropriations-act-permits-midyear-fsa-elections-and-unlimited-carryover-amounts-through-2021.aspx](http://www.shrm.org/ResourcesAndTools/hr-topics/benefits/pages/appropriations-act-permits-midyear-fsa-elections-and-unlimited-carryover-amounts-through-2021.aspx)), *SHRM Online*, January 2021

2021 FSA Contribution Cap Stays at \$2,750, Other Limits Tick Up ([www.shrm.org/ResourcesAndTools/hr-topics/benefits/pages/2021-fsa-contribution-cap-and-other-colas.aspx](http://www.shrm.org/ResourcesAndTools/hr-topics/benefits/pages/2021-fsa-contribution-cap-and-other-colas.aspx)), *SHRM Online*, October 2020

#### Related SHRM Resource:

CAA 2021: FSA Rules Relaxed ([www.shrm.org/ResourcesAndTools/tools-and-samples/exreq/Pages/Details.aspx?Erid=1660](http://www.shrm.org/ResourcesAndTools/tools-and-samples/exreq/Pages/Details.aspx?Erid=1660)), SHRM Express Requests

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