



## IRS releases Notice 2021-15

### With client needs and voices in mind, IRS Notice 2021-15 provided an incredible win for the industry

On December 27, 2020, President Trump signed into law the [Consolidated Appropriations Act, 2021 \(CAA\)](#).<sup>1</sup> One of the largest spending measures ever enacted, the CAA included \$1 trillion in COVID-19 related relief. The CAA introduced several temporary flexibility provisions with respect to health flexible spending arrangements (Health FSAs) and dependent care flexible spending arrangements (DCFSA). As we previously indicated<sup>2</sup>, the relief actions were complex.

#### We're in Your Corner...

In the response to the complexity of the CAA, HealthEquity held explanatory and advisory webinars to assist our partners, clients, and colleagues in the industry with the finer points of the largest health care legislative package since the inception of the Affordable Care Act. With more than 5,000 attendees, we took careful notes of the recurrent questions, points of clarification, and areas of concern. With client voices and needs in mind, Jody Dietel (Senior Vice President, Advocacy and Government Affairs) submitted comments on behalf of HealthEquity to the IRS and Treasury on the COVID-19 relief changes and their impact on account-based plans.<sup>3</sup>

We are happy to report an incredible win for the industry with the recent release of the IRS Notice 2021-15 (The "Notice"). The Notice verified our points for which we requested confirmation of understanding. A comparison of our itemized comments<sup>4</sup> and the commensurate responses in The Notice is available [here](#).

#### IRS Notice 2021-15 Summary

**The Notice provided the below clarifications as it relates to the carryover provisions:**

- Plans that do not currently have carryover can adopt carryover;
- Plans that currently have a grace period can retroactively terminate grace period and add carryover;
- Employers may adopt the relief for only some participants (subject to the Internal Code's nondiscrimination rules);
- An employer can require re-enrollment in the subsequent plan year to have access to any carryover amounts;
- An employer can require a minimum election for the Health FSA or DCFSA in the subsequent plan year to have access to the carryover;
- The employer can apply a deadline before the end of the plan year in which the employee must use the carried over amount;
- An employer can restrict the carryover amount to a specific dollar amount less than all unused benefits or contributions;
- A COBRA qualified beneficiary has a right to carryover dollars; and

<sup>1</sup> <https://www.congress.gov/116/bills/hr133/BILLS-116hr133enr.pdf>

<sup>2</sup> <https://drq94yec07kda.cloudfront.net/cares/ConsolidatedAppropriationAct2021.pdf>

<sup>3</sup> <https://healthequity.com/doclib/compliance/HQY-comments-on-Consolidated-Appropriations.pdf>

<sup>4</sup> <https://healthequity.com/doclib/compliance/Request-For-Guidance-CAA-2021.pdf>

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- If an employee did not elect the Health FSA for the 2021 plan year, but later in 2021 elects to participate prospectively, the employee can receive the carryover from 2020 (if any). Members can use the carried over amount to pay expenses incurred on or after January 1, 2021.

## **The Notice provided the following clarifications regarding the extended time for incurring claims:**

- An employer may choose to adopt an extended period for incurring claims that is less than 12 months;
- Plans that currently do not have a grace period can adopt the extended grace period provision;
- An employer may adopt an extended grace period for some, but not all, participants (subject to the Code's nondiscrimination rules);
- An employee may not contribute to an HSA if they participate in a general-purpose Health FSA during a grace period; and
- A COBRA qualified beneficiary has a right to the extended grace period.

## **The Notice confirmed the following regarding the spend-down provision for Health FSAs:**

- Employer groups may limit spend-down amounts to unused contributions through the end of the plan year in which participation ceased (including any grace period); and
- The provision applies to employees who terminate participation for any reason during the plan year, including termination of employment, change in employment status, or an election change.

Examples were also provided in the Notice regarding the interaction of spend-down and COBRA. Please see below:

- Example 1: If an employer allows an employee who ceases to be a participant - as the result of termination of employment or change in employment status - to be reimbursed for expenses incurred after the termination or reduction in hours through access to the amount of salary reduction contributions that have been made as of the date the employee ceased being a participant, this event would constitute a COBRA qualifying event subject to notice requirements.
- Example 2: If an employee elected to contribute \$2,400 to a Health FSA, terminated employment on January 31 after making \$200 in salary reduction contributions, and - as a result of the termination - was no longer permitted to contribute to the Health FSA other than by electing COBRA continuation coverage, the employer may allow the employee to request reimbursement for up to \$200, or the employee may elect COBRA continuation coverage to have access to \$2,400 by paying the applicable COBRA premium of \$200 per month on an after-tax basis.

## **The Notice expands upon the Healthcare coverage election change relief introduced in the CAA:**

- Permits employers – for plan years ending in 2021 – to allow employees prospectively to change an election under employer-sponsored health insurance coverage (e.g., health,



dental, or vision coverage). Similar to the relief provided in Notice 2020-29<sup>1</sup>, plans may allow (1) new elections for coverage by employees who initially declined coverage; (2) elections to enroll in different health insurance coverage sponsored by the same employer (including a change of enrollment from self-only to family coverage); (3) revocation of existing elections with a written attestation from the employee that (s)he is enrolled – or immediately will enroll – on other coverage not sponsored by the employer.

**The Notice confirmed the following regarding the HSA interaction with Health FSAs:**

- Confirms that the expanded carryover and extended grace periods – if adopted by a general-purpose Health FSA – *will* constitute an extension of impermissible coverage under a health plan; an individual would therefore be ineligible to make HSA contributions during a month in which the amounts remaining (by carryover or the extended grace period) are available to that individual.
- Provides that plans can be amended to allow employees to opt out of a carryover or extended period for incurring claims in plan years ending in 2021 and 2022 to preserve HSA eligibility.
- If the plan does not allow an employee – following a revocation of a general-purpose Health FSA election – to permit that employee to continue to reimburse eligible expenses incurred following the date on which the revocation is made, the plan can permit the employee to contribute to an HSA following such a termination.

**The Notice provided two very helpful examples regarding the timing of amendments for employers that choose to adopt any of the provisions for their health FSA or DCFSA:**

- Calendar plan year: For example, if an employer sponsors a calendar year § 125 cafeteria plan with a Health FSA that provides for a \$550 carryover (from 2020 to 2021) and amends the plan to carry over the entire unused amount remaining in employees' Health FSAs as of December 31, 2020, to the 2021 plan year, the amendment must be adopted by December 31, 2021.
- Non-calendar plan year: An amendment for the 2020 plan year of a non-calendar year plan, however, must be adopted by December 31, 2022, because the last day of the first calendar year beginning after the end of the 2020 plan year that ends in 2021 is the last day of 2022.

**The Notice clarified that amendments to allow OTC drugs and menstrual care products to be reimbursed can be retroactive beginning on or after January 1, 2020.**

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<sup>1</sup> <https://www.irs.gov/pub/irs-drop/n-20-29.pdf>



## The full Compliance Alert for IRS Notice 2021-15 follows:

### Carryovers

The CAA included a provision to allow carryover of any unused benefits or contributions remaining in a health FSA or DCFSA for the following plan years:

- **CARRYOVER FROM 2020 PLAN YEAR.** For plan years ending in 2020, a plan that includes a Health FSA or DCFSA may allow any unused benefits or contributions remaining in either arrangement to be carried over from such plan year to the plan year ending in 2021. Note: This effectively eliminates (at the plan sponsor's option) any cap on carryover of unused funds that previously existed<sup>1</sup> for the 2020 and 2021 plan years. It also applies, for the first time, to DCFSA's.
- **CARRYOVER FROM 2021 PLAN YEAR.** For plan years ending in 2021, a plan that includes a Health FSA or DCFSA may allow any unused benefits or contributions remaining in either arrangement to be carried over from such plan year to the plan year ending in 2022.

The Notice provided the below clarifications as it relates to the carryover provisions:

- Plans that do not currently have carryover can adopt carryover;
- Plans that currently have a grace period can retroactively terminate grace period and add carryover;
- Employers may adopt the relief for only some participants (subject to the Internal Code's nondiscrimination rules);
- An employer can require re-enrollment in the subsequent plan year to have access to any carryover amounts;
- An employer can require a minimum election for the Health FSA or DCFSA in the subsequent plan year to have access to the carryover;
- The employer can apply a deadline before the end of the plan year in which the employee must use the carried over amount;
- An employer can restrict the amount of the carryover amount to a specific dollar amount less than all unused benefits or contributions;
- A COBRA qualified beneficiary has a right to carryover dollars; and
- If an employee did not elect the Health FSA for the 2021 plan year, but later in 2021 elects to participate prospectively, the employee can receive the carryover from 2020 (if any). He/she can use the carried over amount to pay expenses incurred on or after January 1, 2021.

### Grace Periods

The CAA provided that employers may extend the grace period for Health FSA and DCFSA's for a plan year ending in 2020 or 2021 to 12 months after the end of such plan year, with respect to unused benefits or contributions remaining in either arrangement.

The Notice provided the following clarifications regarding the extended time for incurring claims:

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<sup>1</sup> <https://www.irs.gov/pub/irs-drop/n-20-33.pdf>

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- An employer may choose to adopt an extended period for incurring claims that is less than 12 months;
- Plans that currently do not have a grace period can adopt the extended grace period provision;
- An employer may adopt an extended grace period for some, but not all, participants (subject to the Code's nondiscrimination rules);
- An employee may not contribute to an HSA if they participate in a general-purpose Health FSA during a grace period; and
- A COBRA qualified beneficiary has a right to the extended grace period.

## Spend Down for Health FSAs (Similar to DCFSA)

In addition, the CAA allowed for a plan that includes a Health FSA to allow (similar to the rules applicable to DCFSA) an employee who ceases participation in the plan during calendar year 2020 or 2021 (e.g., due to termination of employment) to continue to receive reimbursements from unused benefits or contributions for expenses incurred through the end of the plan year in which such participant ceased participation (including any extended grace period).

The Notice confirmed the following regarding the spend-down provision for Health FSAs:

- Employer groups may limit spend-down amounts to unused contributions through the end of the plan year in which participation ceased (including any grace period); and
- The provision applies to employees who terminate participation for any reason during the plan year, including termination of employment, change in employment status, or an election change.

Examples were also provided in the Notice regarding the interaction of spend-down and COBRA. Please see below:

- Example 1: If an employer allows an employee who ceases to be a participant - as the result of termination of employment or change in employment status - to be reimbursed for expenses incurred after the termination or reduction in hours through access to the amount of salary reduction contributions that have been made as of the date the employee ceased being a participant, this event would constitute a COBRA qualifying event subject to notice requirements.
- Example 2: If an employee elected to contribute \$2,400 to a Health FSA, terminated employment on January 31 after making \$200 in salary reduction contributions, and - as a result of the termination - was no longer permitted to contribute to the Health FSA other than by electing COBRA continuation coverage, the employer may allow the employee to request reimbursement for up to \$200, or the employee may elect COBRA continuation coverage to have access to \$2,400 by paying the applicable COBRA premium of \$200 per month on an after-tax basis.

## Special Carry Forward Rule for DCFSA Where Dependents Aged Out During the Pandemic

The CAA also indicated an "eligible employee" may be reimbursed for an eligible dependent who is not yet age 14 (previously age 13) for purposes of determining the dependent care assistance which may be paid or reimbursed with respect to such employee under the dependent care FSA. The term "eligible employee" is defined as any employee who (A) is enrolled in a DCFSA for the



last plan year with respect to which the end of the regular enrollment period for such plan year was on or before January 31, 2020; and (B) has one or more dependents (as defined in Internal Revenue Code § 152(a)(1)) who attain the age of 13— (i) during such plan year, or (ii) in the case of an employee who (after the application of this section) has an unused balance in the employee's account under such arrangement for such plan year (determined as of the close of the last day on which, under the terms of the plan, claims for reimbursement may be made with respect to such plan year), the subsequent plan year.

An employer can adopt this relief without adopting a carryover or extended grace period.

## FSA Election Changes

For plan years ending in 2021, a plan that includes a Health FSA or DCFSA may allow an employee to make an election to modify prospectively the amount (but not in excess of any applicable dollar limitation) of such employee's contributions to any Health FSA or DCFSA (without regard to any change in status). This extends the election change relief that the IRS provided for Health FSAs in Notice 2020-29 for an additional year.

- While the election change is prospective only, employers may allow an employee to use the amounts contributed to the Health FSA after the election revision for eligible expenses incurred in the 2021 plan year prior to that change (even if the employee was not enrolled in the plan as of January 1, 2021).
- An employer can amend the plan so that – following an employee revoking her or his Health FSA election – the amounts contributed to the Health FSA prior to the election (1) remain available for eligible expenses incurred after the election is revoked; (2) may only be used to reimburse eligible expenses incurred prior to the date of revocation; or (3) are forfeited following the revocation date.
- An employer is permitted to limit mid-year election changes, such as only up to a certain date, prohibiting increases in elections, or preventing election changes to decrease below amounts already reimbursed.
- The Notice expands upon the Health FSA election change relief introduced in the CAA by permitting employers – for plan years ending in 2021 – to allow employees prospectively to change an election under employer-sponsored health insurance coverage (i.e., health, dental, or vision coverage). Similar to the relief provided in Notice 2020-29<sup>1</sup>, plans may allow (1) new elections for coverage by employees who initially declined coverage; (2) elections to enroll in different health insurance coverage sponsored by the same employer (including a change of enrollment from self-only to family coverage); (3) revocation of existing elections with a written attestation from the employee that (s)he is enrolled – or immediately will enroll – on other coverage not sponsored by the employer.

## HSA Interaction with Health FSAs

Generally, coverage under a general purpose Health FSA – including coverage due to carryover or during a grace period (if there is a remaining balance as of the last day of the plan year) – will make an employee ineligible to make contributions to a Health Savings Account (HSA). However, an employee who is enrolled in a Limited Purpose or post-deductible FSA (both of which are HSA-

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<sup>1</sup> <https://www.irs.gov/pub/irs-drop/n-20-29.pdf>

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compatible) or whose general purpose Health FSA is converted to a Limited Purpose or post-deductible Health FSA will not disqualify that individual from contributing to an HSA.

The Notice confirms that the expanded carryover and extended grace periods – if adopted by a general-purpose Health FSA – *will* constitute an extension of impermissible coverage under a health plan; an individual would therefore be ineligible to make HSA contributions during a month in which the amounts remaining (by carryover or the extended grace period) are available to that individual.

However, employers have options to avoid negatively impacting an individual's eligibility to make HSA contributions. Generally, employers are permitted, on an employee-by-employee basis, to allow employees to opt-out of the carryover; or to carryover funds from their general-purpose Health FSA into an HSA-compatible Health FSA. Conversely, employers *cannot* permit employees to waive coverage under a grace period, and conversion from a general-purpose Health FSA into an HSA-compatible Health FSA during a grace period is only permitted for *all* participants.

While the CAA did not address the downstream impact of this relief to HSA-eligibility, the Notice provides that plans can be amended to allow employees to opt out of a carryover or extended period for incurring claims in plan years ending in 2021 and 2022 to preserve HSA eligibility.

If the plan does not allow an employee – following a revocation of a general-purpose Health FSA election – to permit that employee to continue to reimburse eligible expenses incurred following the date on which the revocation is made, the plan can permit the employee to contribute to an HSA following such a termination.

## Plan Amendments

The temporary flexibility provided to Health FSA and DCFSA outlined in CAA are optional. Employers should review their plan designs and consider which provisions they would like to adopt. If an employer chooses to adopt any of the provisions a plan amendment is required. The CAA indicated plan amendments could be adopted retroactively if two things occurred:

- (1) the amendment is adopted not later than the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective, and
- (2) the plan or arrangement is operated consistent with the terms of the amendment during the period beginning on the effective date of the amendment and ending on the date the amendment.

The Notice provided two very helpful examples regarding the timing of amendments for employers that choose to adopt any of the provisions for their health FSA or DCFSA:

- **Calendar plan year:** For example, if an employer sponsors a calendar year § 125 cafeteria plan with a Health FSA that provides for a \$550 carryover (from 2020 to 2021) and amends the plan to carry over the entire unused amount remaining in employees' Health FSAs as of December 31, 2020, to the 2021 plan year, the amendment must be adopted by December 31, 2021.
- **Non-calendar plan year:** An amendment for the 2020 plan year of a non-calendar year plan, however, must be adopted by December 31, 2022, because the last day of the first



calendar year beginning after the end of the 2020 plan year that ends in 2021 is the last day of 2022.

## Over the Counter (OTC) Drugs and Menstrual Care Items

The CARES Act eliminated the Affordable Care Act provision that required a prescription for OTC drugs and medicines for Health FSAs, health reimbursement arrangements (HRAs) or health savings accounts (HSAs). In addition, menstrual care products were deemed as eligible expenses for reimbursement under the Health FSA, HRA and HSA.

These expenses – incurred after December 31, 2019 - can be reimbursed following the adoption of plan amendments to allow these expenses. Regarding Health FSA and HRA plan amendments to allow OTC drugs and menstrual care products to be reimbursed, the Notice clarified that amendments to allow this coverage can be retroactive beginning on or after January 1, 2020.

## Conclusion

The Notice provides employers with more flexibility with regards to the administration of their plans as well as the opportunity for the employees to make decisions mid-year concerning certain plan offerings. Those employers must decide what plan changes and to what extent those changes will apply to fit their specific plan needs. As more employers make the decisions to amend their plans and notify the plan participants, it is important to remember that the amendments for the 2020 plan year may be completed as late as December 31, 2021. Changes for plans ending in 2021 may be implemented as late as December 31, 2022. As always, any time an employer is amending their plan, it would be prudent to consult experienced legal counsel with questions and for guidance based on any applicable federal, state, or local laws.

As part of the services provided by HealthEquity, we will continue to stay abreast of this topic and, as additional guidance is available, we will advise accordingly.

Information contained in this memo is not intended to be legal, accounting, or other professional advice. We assume no liability whatsoever in connection with its use, nor are these comments directed to specific situations.