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Re: Request for Guidance Regarding Flexible Spending Arrangement Provisions in the Consolidated Appropriations Act, 2021

Dear Ms. Weiser, Ms. Morrison, Ms. Levy and Mr. Tackney,

I am writing on behalf of the American Benefits Council ("the Council") to request that the Treasury Department and the Internal Revenue Service (IRS) issue clarifying guidance on the temporary special rules for health and dependent care flexible spending arrangements (FSAs) contained in the Consolidated Appropriations Act, 2021 (CAA), enacted on December 27, 2020 (the "FSA provisions"). I am also writing to share the questions we have received thus far from our employer members on the FSA provisions, to highlight the areas where clarification and confirmation would be most helpful.

The Council is dedicated to protecting employer-sponsored benefit plans. The Council represents more major employers – over 220 of the world's largest corporations – than any other association that exclusively advocates on the full range of employee

benefit issues. Members also include organizations supporting employers of all sizes. Collectively, Council members directly sponsor or support health and retirement plans covering virtually all Americans participating in employer-sponsored programs.

Throughout the COVID-19 crisis, the Council has been working to support our employer members as they address the impacts of the crisis on their employees and their employees' families. Concerns related to health and dependent care FSAs have been a top-tier concern expressed by employers, based on feedback from their employees. The main issue being that, amid an economic crisis, employees could lose contributions to health and dependent care FSA balances, through no fault of their own. The Council previously raised these concerns in detail with Treasury, IRS and Congress.[1] We greatly appreciated Treasury and IRS issuing Notice 2020-29, which addressed these concerns during 2020 and we were thrilled to see relief for 2021 and some relief for 2022, contained in the FSA provisions in the CAA.

We understand that Treasury and IRS are considering issuing guidance regarding the FSA provisions contained in the CAA and based on the questions we have received from employers, we encourage Treasury and IRS to do so. Guidance would be helpful to provide clarity to employer plan sponsors and to ensure that the FSA provisions are implemented consistently and efficiently by those employers that elect to do so. We also ask that any clarifying guidance be provided as soon as possible, as many employers and their employees are eager for implementation.

To give you a sense of where guidance would be most helpful, below we list the questions we have heard from employers thus far. We have shared some of these issues with you informally already and thank you, as always, for your responsiveness and willingness to consider the issues we raise.

Lastly, we note that this letter is focused solely on the FSA provisions in the CAA. We continue to review and analyze the many other provisions of the CAA relevant to employer plan sponsors and will follow up separately on those provisions as questions and issues arise.

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[1] See April 13, 2020, Council letter to Treasury and IRS at https://www.americanbenefitscouncil.org/pub/?id=8B12F3A3-1866-DAAC-99FB-999F1A090977, October 23, 2020, Council letter to Treasury and IRS at https://www.americanbenefitscouncil.org/pub/?id=FE5ED9AE-1866-DAAC-99FB-EF93B575B73D and Council June 2, 2020, public policy recommendations shared with Congress at https://www.americanbenefitscouncil.org/pub/9DBEDD63-1866-DAAC-99FB-265ECC598AED.

INCREASED CARRYOVER AND EXTENDED GRACE PERIOD

The CAA provides that employers may allow unused benefits or contributions in health and dependent care FSAs remaining at the end of the 2020 plan year to carry over to the plan year ending in 2021 and/or to allow carryover of unused benefits or contributions from the 2021 plan year to the plan year ending in 2022. The CAA also allows a health or dependent care FSA to extend its grace period for a plan year ending in 2020 or 2021 to 12 months, with respect to unused benefits or contributions. These provisions address the most significant FSA concerns raised by our employer members and their employees during the COVID-19 crisis and these provisions are also the focus of the majority of the questions we have received. For the sake of clarity, below we organize the questions we have received by category – general questions, health FSA specific questions and lastly, dependent care FSA specific questions.

General Questions

- ***Timing of Operational Adoption:*** It would be helpful to have confirmation of the operational window for an employer to adopt the new carryover or grace period relief. For example, could an employer operationally decide to add the increased carryover to its 2020 calendar year plan in say February 2021, or after the runout period has ended and have the entire carryover amount be retroactive to January 1, 2021, with the amendment to occur no later than December 31, 2021? We interpret the CAA to allow this, especially given the timing of the passage (five days before the end of most FSA plan years) and the intent of the law to provide meaningful relief to employers and employees during the COVID-19 crisis. Our sense is that during the last few days of 2020, many employers were not yet aware that they could even permit a special carryover or grace period and even if so, had not yet made or operationalized that decision and may want to see all the accounting for 2020 balances (which are not yet fully calculated) before deciding. For the many employers who are currently deciding if and how to implement these new provisions, confirmation of the ability to operationalize in 2021, retroactively, would be very helpful. It would also be helpful to have clarification as to how the relief applies for plans that only allow a carryover for employees who have enrolled in the next plan year. That is, if an employer adopts the increased carryover (and the change in election flexibility) mid-year and an employee subsequently elects to participate in the FSA mid-year, would the election be prospective and would the carryover amount be effective back to January 1, 2021?

- ***Types of Plans Allowed to Adopt Relief:*** It would also be helpful to have confirmation that employers may adopt this relief even if they had not previously provided a carryover or grace period. There are employers with non-carryover/grace period plans, including obviously dependent care FSAs which have not, until the CAA, been allowed to provide a carryover. Maximum

flexibility, allowing employers to retroactively adopt a grace period or carryover, would be useful, especially due to the enactment of the CAA so late in the year.

- ***Grace Period or Carryover:*** There is some confusion as to whether an employer can adopt both a carryover and a grace period, or just one or the other (which we recognize is the current rule).

- ***Length of Grace Period:*** The CAA allows FSAs to extend grace periods for 2020 and 2021 "to 12 months after the end of such plan year." We have been asked if this would allow an employer to extend the grace period to some period shorter than 12 months, say six months. Ideally, employers would be able to determine the grace period length, with 12 months being the maximum.

- ***Plan-by-Plan Application:*** It would be helpful to receive confirmation that an employer may implement the carryover and/or grace period just for a health care FSA, or just for a dependent care FSA (and need not extend the relief to both). It would also be helpful to have confirmation that employers have the discretion to extend the relief to some, but not all, health or dependent care FSA participants. We assume this is the case, based on the amount of flexibility employers currently have regarding the offering and design of health and dependent care FSAs, but we note that this question has been asked.

Health FSA Questions

- ***Health Savings Account (HSA) Interaction:*** It would be helpful to see explanatory guidance on how the special carryover and grace period rules for health FSAs in the CAA interact with the HSA eligibility rules, in particular because there appears to be a substantive difference depending on whether an employer chooses to provide a carryover or grace period.

  Employers want to understand what options they have to preserve HSA eligibility for employees for whom a special carryover or grace period is provided. We understand that guidance has been issued previously[2] on the rules that pre-date the CAA and that under that guidance, the rules regarding the interaction of health FSAs and HSAs differ depending on whether a health FSA offers carryover or has a grace period. More specifically, coverage under a general purpose health FSA always precludes HSA eligibility, but employers can instead offer an HSA-compatible FSA (i.e., limited purpose or post-deductible

[2] See IRS Chief Counsel Memorandum 201413005 (regarding health FSA carryovers and HSAs) at https://www.irs.gov/pub/irs-wd/1413005.pdf and Notice 2005-86 (regarding health FSA grace periods and HSAs) at https://www.irs.gov/pub/irs-drop/n-05-86.pdf.

health FSA). Notably, the guidance to date allows employees to decline carryover amounts to maintain HSA eligibility, whereas the current guidance does not permit individuals to decline a grace period. In addition, employers may provide an HSA-compatible FSA for carryover for employees in a high-deductible health plan (HDHP) and a general purpose FSA for other employees, whereas under the grace period rules, if an employer wishes to provide an HSA-compatible FSA during the grace period, it must do so for all employees (even those not enrolled in an HDHP). Due to these differences and the substantial number of employees who wish to contribute to HSAs, confirmation and explanation of these rules as applied in the current context would be helpful.

We also reiterate our request from our October 23 letter that special rules be provided for the extended grace period in this instance.[3] For an employer that chooses to offer the extended grace period, requiring that either all employees be rendered ineligible for an HSA or that the employer limit the scope of the FSA reimbursements for all employees for the duration of the grace period seems an overly narrow application of the rules and one that can be made more flexible, as justified by the unique challenges presented by the current crisis. As such, we would welcome guidance that would allow employers to permit employees, on an employee-by-employee basis, to opt-out of the extended grace period, in order to preserve their HSA eligibility. In addition, we ask that employers be allowed to offer employees the choice between an HSA-compatible health FSA or general purpose health FSA during the grace period, on an employee-by-employee basis, or to implement a plan design such that employees who elect an HDHP are automatically enrolled in an HSA-compatible FSA. For ease of administration and to give maximum effect to the relief in the CAA, it would also be helpful to have guidance providing that, to the extent these changes are made mid-year, prospectively, the individual will not be rendered HSA-ineligible for the earlier part of the plan year.

- ***COBRA Interaction:*** We have been asked about the interaction of COBRA and the FSA provisions. In particular, whether, if a participant terminated employment in 2020 and the plan adopts the special grace period or carryover and the participant elects COBRA, he/she must have access to the grace period/carryover as well (without additional COBRA premium attached)? That is our understanding, based on Notice 2015-87, Q&A 23[4] (with the caveat provided in Q&A 24 for FSAs that condition carryover on participation in the

[3] See October 23, 2020 Council letter to Treasury and IRS at https://www.americanbenefitscouncil.org/pub/?id=FE5ED9AE-1866-DAAC-99FB-EF93B575B73D.

[4] See Notice 2015-87 at https://www.irs.gov/pub/irs-drop/n-15-87.pdf.

health FSA in the next year) but this is something else it would be helpful to see guidance on, as confirmation.

It would also be helpful for Treasury and IRS to confirm that the amount available under the special carryover or grace period is included in the determination of the amount of the benefit to which a qualified beneficiary is entitled (per Q&A 21 of Notice 2015-87). This is relevant in determining whether the employer has an obligation to provide COBRA coverage for the health FSA because under the COBRA regulations[5], an excepted benefit health FSA is not obligated to make COBRA coverage available for the plan year in which a qualifying event occurs unless, as of the date of the qualifying event, the amount the qualified beneficiary may become entitled to receive during the remainder of the plan year as a benefit exceeds the amount the health FSA may require to be paid for COBRA continuation coverage for the remainder of the plan year.

- ***Excepted Benefit Interaction:*** Confirmation is requested that the carryover and grace period amounts should not be taken into account when determining if the health FSA satisfies the maximum benefit payable limit prong under the test set forth in the excepted benefits regulation.[6] That seems clear from previous guidance addressing the same question with regards to the carryover rules that pre-date the CAA, but confirming guidance, that also addresses the extended grace period, would be helpful.[7]

- ***Amount to Carryover/Allow in Grace Period:***

    - *2020 Amounts/2021 Contributions*: Because it is the key element of this relief, it would be helpful to confirm that employers may allow employees to carryover or make available in the extended grace period the full unused amount remaining in the health FSA. So, for example, as we understand, employees may carryover the full unused amounts from 2020 (e.g., $2,750) to 2021 and contribute $2,750 in 2021 and all of those contributions could be available for reimbursement for expenses incurred during 2021.

    - *2020 and 2021 Amounts and 2022 Contributions*: It would also be helpful to have confirmation that carryover amounts from 2020 into 2021 do not

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[5] See 26 CFR 54.4980B-2, Q&A-8(e).

[6] See 26 CFR 54.9831-1(c)(3)(v).

[7] See Q&A 6 of Affordable Care Act FAQs (Part XIX) at https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/faqs/aca-part-xix.pdf.

expire at the end of 2021 (if unspent) and instead can carry forward to 2022, in the employer's plan design discretion. For example, if an employee carried forward $2,750 from 2020 to 2021, contributed $2,750 in 2021 and did not spend any of those amounts – could the employee be allowed to carry forward the full $5,550 to 2022 and contribute the maximum amount for 2022? That is our understanding based on the statutory text, but confirmation would be helpful.

- *2019 Amounts*: We have also received questions regarding how carryover amounts from the 2019 plan year to the 2020 plan year should be treated. Part of what is giving rise to the questions here is that uncertainty continues to exist regarding carryover amounts available in 2020, from 2019, due to the guidance issued by the Departments of Labor and Treasury extending the time period for employees to submit claims for the runout period associated with 2019.[8] Due to the extension of timeframes guidance, it is still unclear whether certain employees can carryover amounts from 2019 into 2020 and the amount of the carryover, because the deadline for them to submit claims for 2019 is paused until after the "outbreak period" (or, if earlier, the 1-year maximum tolling period) ends.[9] As such, we have been asked whether, if the 2019 plan year isn't closed until 2021, due to the extended run-out period, is the 2019 carryover limited to $500 or is it unlimited? On a more basic level, it would be helpful to have confirmation that the carryover from 2019 into 2020, whatever it may be, can be carried into 2021, as part of the unlimited carryover allowed under the CAA.

Dependent Care FSA Questions

- ***Exclusion Limit*:** We have been asked whether the extended grace period or carryover changes the amount of reimbursements that can be excluded in a taxable year for a dependent care FSA under Internal Revenue Code Section 129(a)(2)(A) (i.e., $5,000 (or $2,500 in the case of a married individual filing separately)). For example, if an employee carries forward $5,000 from 2020 into 2021, contributes $5,000 in 2021 and incurs $10,000 in dependent care expenses in

[8] See Extension of Certain Timeframes for Employee Benefit Plans, Participants and Beneficiaries Affected by the COVID–19 Outbreak.

[9] We reiterate our prior request for confirmation as to the end of the "outbreak period", as described in more detail in the Council's Memo to the Biden-Harris Administration Transition Teams: Legislative & Regulatory Proposals Related to COVID-19 available at https://www.americanbenefitscouncil.org/pub/?id=79DFE43E-1866-DAAC-99FB-7F285CF11A93.

2021, is the employee limited to receiving $5,000 of dependent care expense reimbursements in 2021? If so, would the employer be required to limit the 2021 salary reduction election to $0? We understand that currently, if a dependent care FSA includes a two and a half month grace period, the exclusion amount is not increased due to the amounts available in the grace period.[10] But due to the significantly extended duration of the grace period and the fact that, until the CAA, dependent care FSAs were not allowed to provide for carryovers, clarifying guidance would be helpful and, practically speaking, will help employers and employees determine contributions for 2021 and 2022. It would also be helpful to have guidance addressing whether an employer may reimburse qualifying dependent care expenses during 2021 or 2022, above the $5,000 exclusion limit, so long as those reimbursement amounts are included in income and to address what actions, if any, employers should take regarding employees who may have already, based on the combination of carryover and contributions to date, exceeded $5,000 of combined carryover/grace period amounts and new 2021 contributions.

- ***W-2 Reporting:*** In general, employers are required to report, in Box 10, of the Form W-2, Wage and Tax Statement, the total dependent care benefits under a dependent care assistance program paid or incurred by the employer for the employee. Guidance was provided in Notice 2005-61, following guidance allowing dependent care FSAs to include grace periods at the employers' discretion, that employers may report in Box 10 for a year the salary reduction amount elected by the employee for the year for dependent care assistance (plus any employer matching contributions) and that, based on the examples provided, employers need not adjust the Box 10 amounts based on any amount that remains available in the grace period. It would be helpful to have confirmation that this guidance applies in the context of the dependent care FSA provisions in the CAA.

- ***Nondiscrimination Testing:*** Confirmation would be helpful as to how amounts made available as carryover or in the extended grace period impact the nondiscrimination testing that applies to dependent care FSAs. Based on current practice (similar to the W-2 reporting rule in Notice 2005-61), our assumption is that the carryover and grace period amounts will not be taken into account in determining whether the dependent care FSA (or health FSA) meets the nondiscrimination rules for a year – and instead, only current year contributions

[10] See IRS Form 2441 (Child and Dependent Care Expenses) at https://www.irs.gov/pub/irs-pdf/f2441.pdf and 2020 Instructions for Form 2441 at https://www.irs.gov/pub/irs-pdf/i2441.pdf.

will be analyzed for a given year, but we note this is an item where we have heard a number of questions.

SPECIAL CARRY-FORWARD RULE FOR DEPENDENT CARE FSAS WHERE DEPENDENT AGED OUT DURING PANDEMIC

The CAA generally provides that, in determining which individuals may be a qualifying dependent for purposes of dependent care FSA expenses, the current maximum age under the Code is increased from 13 to 14. This special rule applies for the last plan year for which the end of open enrollment was on or before January 31, 2020 ("year one") and the subsequent plan year ("year two"), but in year two only for amounts not used during year one.

We have heard that it would be helpful to see examples provided to illustrate this rule. We also note our understanding that employers currently have the discretion to determine which dependents are eligible under the dependent care FSAs they sponsor, within the limits set out in the Code and so employers are not required to extend the age-out age to age 14. Instead, employers may choose whether or not to apply this special rule and as in the normal course, the plan's terms dictate. We also note our understanding that the special provision does not permit an employer to reimburse expenses for a child who is age 14 years or older and instead limits the extension to children who are 13. We note these few items as they have been the subject of questions we have heard and so confirmation could be helpful.

POST-TERMINATION REIMBURSEMENTS FROM HEALTH FSAS

The CAA provides that a health FSA may allow an employee who ceases participation in the plan during calendar year 2020 or 2021 to continue to receive reimbursements "from unused benefits or contributions" through the end of the plan year in which participation ceased, including any grace period.

- ***Amount Made Available:*** Questions have arisen as to the amount that the employer would need to make available in a post-termination health FSA if the employer were to choose to adopt this provision – that is, is this the health FSA balance taking into account only the unused salary reduction contributions that have actually been made to date or taking into account the full amount elected by the employee for the year? As in this case the employee will not be making additional contributions, the former seems to make the most sense (and is how the rule works for dependent care FSAs since dependent care FSA balances are

based on what the employee has contributed to date rather than the full amount elected for the year).[11]

- ***COBRA Interaction:*** In addition, we have received questions as to whether providing the post-termination reimbursement health FSA would constitute a COBRA qualifying event and if so, in what case (i.e., is it contingent on the amount made available by the employer, as raised in the prior paragraph). Again, clarification would be welcome.

- ***Cease Participation:*** We have been asked whether the reference to ceasing participation in the FSA refers to termination of participation or termination of employment. Our understanding, based on the statute, is that the provision is based on ceasing termination in the FSA (not necessarily employment), but confirmation would be helpful.

- ***HSA Interaction:*** Confirmation as to how the HSA-eligibility rules described above apply to post-termination health FSAs has also been requested. Our assumption is the HSA-interaction rules laid out above would apply, as they generally do with regard to health FSAs, but confirmation would be helpful.

PLAN AMENDMENTS

The CAA provides that a plan that includes a health or dependent care FSA will not fail to be treated as a cafeteria plan merely because it is amended pursuant to the FSA provisions and the amendment is retroactive, if 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 "the plan or arrangement is operated consistent with the terms of such amendment during the period beginning on the effective date of the amendment and ending on the date the amendment is adopted."

We have received requests for examples of when amendments must be completed. For example, if a calendar year plan implements a carryover from 2020 to 2021, by what date must the amendment be adopted? Our understanding is that in that case, the amendment would be required by December 31, 2021, but examples from Treasury and IRS would be helpful.

[11] Prop. Treas. Reg. §1.125-6(a)(4)(v).

CHANGE IN ELECTION AMOUNT

The CAA provides that for plan years ending in 2021, a plan that includes a health FSA or dependent care FSA may allow an employee to make an election to modify prospectively the amount of the employee's contribution to the FSA without regard to any change in status.

It would be helpful to have confirmation that employers have the discretion to limit or otherwise determine which types of changes will be allowed and to confirm that, if the employer so chooses, an employee who has not elected any contributions (i.e., $0) could be allowed to make an election prospectively. It would also be helpful to have confirmation that a change in amount cannot be made below year-to-date contributions and that an employer can limit changes in amounts to claims already paid. In addition, examples of limitations that appear permissive would be welcome and appear to include that an employer could allow reductions in contributions but not increases; an employer could permit an election change without status change by a certain date mid-year, but require a status change after that (i.e., no status change needed if the election change is done by 3/31/21, but thereafter would require a status change); and an employer could limit the number of election changes during the year with no associated status change (e.g., only one election change in 2021 without a status change).

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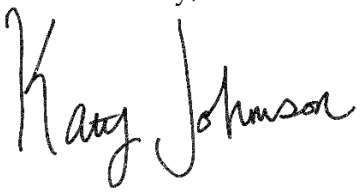
Thank you for considering these questions as you develop guidance on the FSA provisions. The FSA provisions will be a great help to employees and employers during the current crisis and clarifying guidance will make them all the more effective and impactful. We understand that you have many essential matters before you and appreciate your attention to these issues and questions as well.

If you have any questions or would like to discuss these issues further, please contact us at (202) 289-6700.

Sincerely,



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