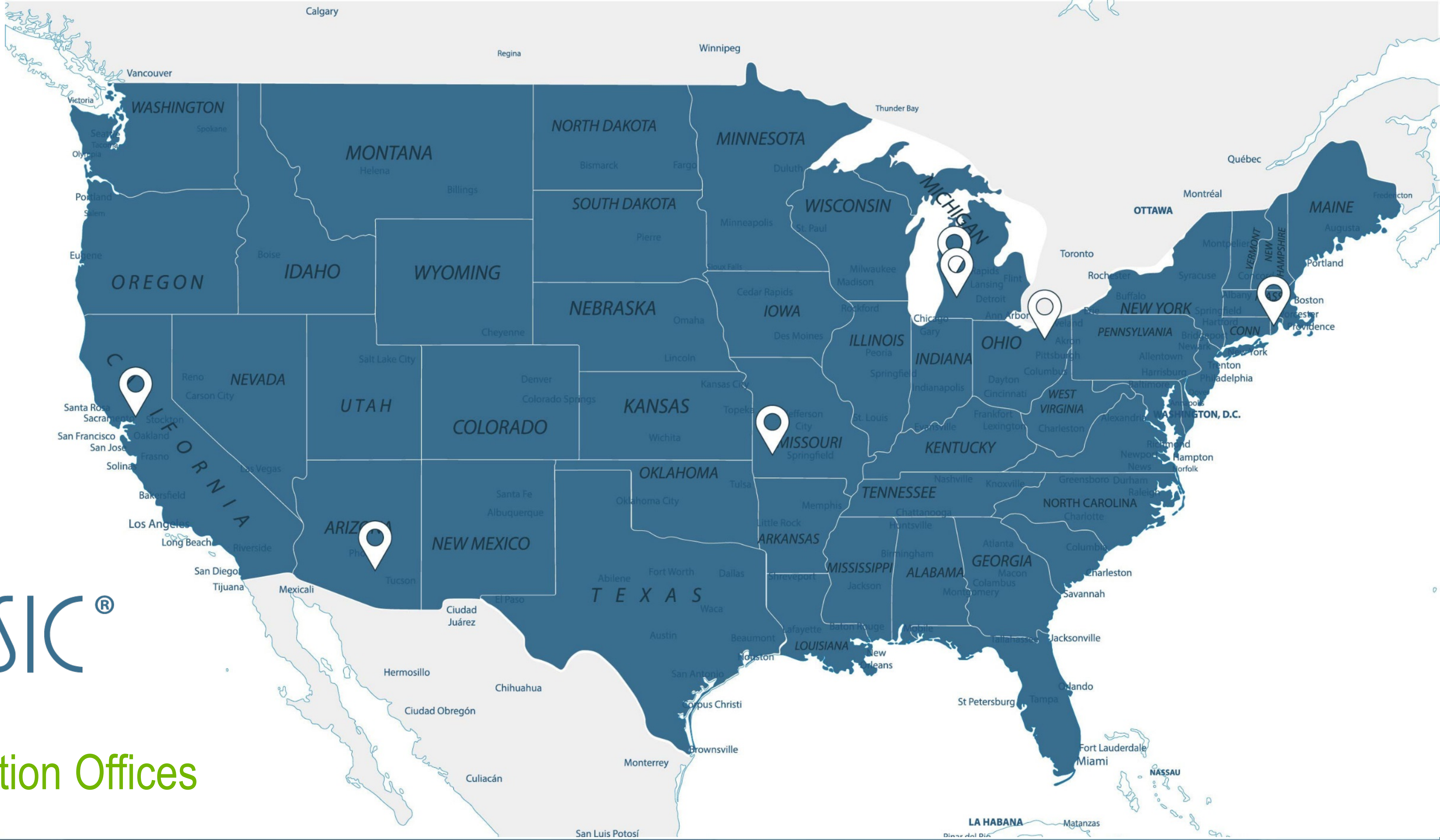
Understanding Health FSA and DCAP Regulations

Including New Regulation Changes During COVID-19



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Presented by

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Cat is the Compliance Officer here at BASIC Benefits. She has extensive experience working with employers and ERISA plan sponsors as an employee benefits attorney. Her umbrella of experience includes, but is not limited to, strategic benefit design, and technical legal compliance under ERISA, COBRA, HIPAA, ACA, LMRA, FMLA, and MHPAEA. She holds an L.L.M. from the John Marshall Law School in employee benefits, a J.D. from the DePaul University College of Law, and a B.A. from Aquinas College.

What Is a Health FSA?

- “FSA” is a Flexible Spending Arrangement, a benefit that can be offered under a Section 125 cafeteria plan
- It is a medical reimbursement plan where an employee can be reimbursed for certain medical expenses using pre-tax dollars
- Multi-faceted nature means that many laws apply to a health FSA and its administration
  - A self-insured medical reimbursement plan; a flexible spending arrangement; group health plan; AND employee welfare benefit plan

What Is a DCAP?

- “DCAP” is a Dependent Care Assistance Program, another benefit that can be offered under a cafeteria plan
- A reimbursement plan that allows up to $5,000 pre-tax dollars to be used by an employer for dependent care assistance
  - Generally a greater benefit than claiming a Dependent Care Tax Credit
- DCAPs are FSAs and are very similar to health FSAs except they are not subject to some of the IRC sections, ERISA, and COBRA
  - Uniform Coverage Rule – the maximum amount of reimbursement must be available at all times during coverage period

Which Laws Apply To a Health FSA?

- Internal Revenue Code § 105, 106, 125, and 213
  - Requires a properly adopted written document (same for DCAP)
  - Can be offered under a cafeteria plan (same for DCAP)
  - Can reimburse only certain medical expenses as defined under § 213(d)
- ERISA, COBRA, HIPAA, FMLA, USERRA, ACA, and others

Which Laws Apply To a Health FSA?

- Prop. Treas. Reg. § 1.125-5 and -6
  - Must offer uniform coverage throughout coverage period
  - Coverage period must be 12 months generally
  - Expenses must have been incurred during coverage period
  - Long-term care expenses and insurance premiums cannot be reimbursed
  - Claim substantiation must be provided, including a statement from the participant and an independent third party (like a physician)
- The IRS released two Notices on May 12, 2020 that alter some health FSA regulations to provide relief to participants

Who Can Participate In a Health FSA?

- Generally, any common-law employee of an employer
- Subject to ACA health plan rules unless FSA meets certain conditions
  - Unless the health FSA only offers limited dental or vision benefits or meets the excepted benefit rules
  - Maximum Benefit (2x participant election or $500) and Availability (nonexcepted health plan coverage available to class of participants by reason of their employment) Conditions
- As an employer:
  - If also offering a major medical plan, offer a health FSA only to those employees eligible for that major medical plan
  - If not offering a major medical plan, offer a limited-scope health FSA for dental and/or vision benefits
  - Watch the amount non-matching employer contributions

Elections

- Under the cafeteria plan, eligible employees will make a prospective (not retroactive) election of benefits and salary reduction amounts, including amount contributed to the health FSA
  - At each annual open enrollment for all eligible employees
  - Within 30 days of hire for new employees
- Generally, elections are **irrevocable** for the coverage period

Midyear Election Changes Pre-COVID

- Under ordinary circumstances, there are several exceptions to the irrevocable rule that allow participants to make a change to their election (Prop. Treas. Reg. § 1.125-4):
    - Change in marital status of the employee
    - Change in number of employee's dependents
    - Change in employment status
    - Change in place of residence
    - And many more…..
- Need to always administer in accordance with the consistency rule
    - Does the requested change match the event?

IRS Notice 2020-29 Mid-year Election Changes

- An employer **may** allow employees to make **prospective** election changes during calendar year 2020
  - An employer may limit the time period during which participants can make election changes
- The following are permitted election changes for both health FSAs and DCAPs:
  - To make a new election and enroll in the health FSA for the first time
  - To revoke an election
  - To decrease or increase an existing election

IRS Notice 2020-29 Mid-year Election Changes

- These mid-year election changes only apply to 2020
  - An employer may adopt all, some, or none
- If any changes are to be applied, there must be an amendment to the plan on or before December 31, 2021
  - However, an employer must inform employees currently of any changes to be adopted
  - Follow SMM distribution rules and but also notify immediately electronically

Use-or-Lose Rule

- The Rule: contributions that have not been used to reimburse expenses incurred during a coverage period must be forfeited
- Exceptions:
  - Carryover – the IRS allows health FSAs to offer carryovers of up to $500 at the end of one plan year to be used for reimbursements in the following plan year
  - Carryovers are not permitted for DCAPs
  - Grace period – plans may offer a grace period of up to two months and 15 days following the end of the plan year during which participants may access unused amounts to pay or reimburse expenses for qualified benefits – may not have a grace period and a carryover

Run-out Period

- Plans may provide a run-out period after a grace period during which expenses incurred during the preceding plan year and grace period may still be paid or reimbursed
- Run-out period allows for extra time to submit a claim, a grace period allows for extra time to incur an expense
- May have a run-out period with a carryover
- A run-out period can last for any length of time
- May have both a run-out period and grace period

Timeline Pre-COVID

- Below is a timeline demonstrating how different periods relate in a plan with a calendar-year, 12-month coverage period, 2.5-month grace period, and 3-month run-out period

Jan. 1

Dec. 31

Mar. 15

June 15

Coverage period – participants are reimbursed for expenses incurred in this time period and can submit claims for that reimbursement

Grace period – participants are reimbursed for expenses incurred in this time period and can submit claims for that reimbursement

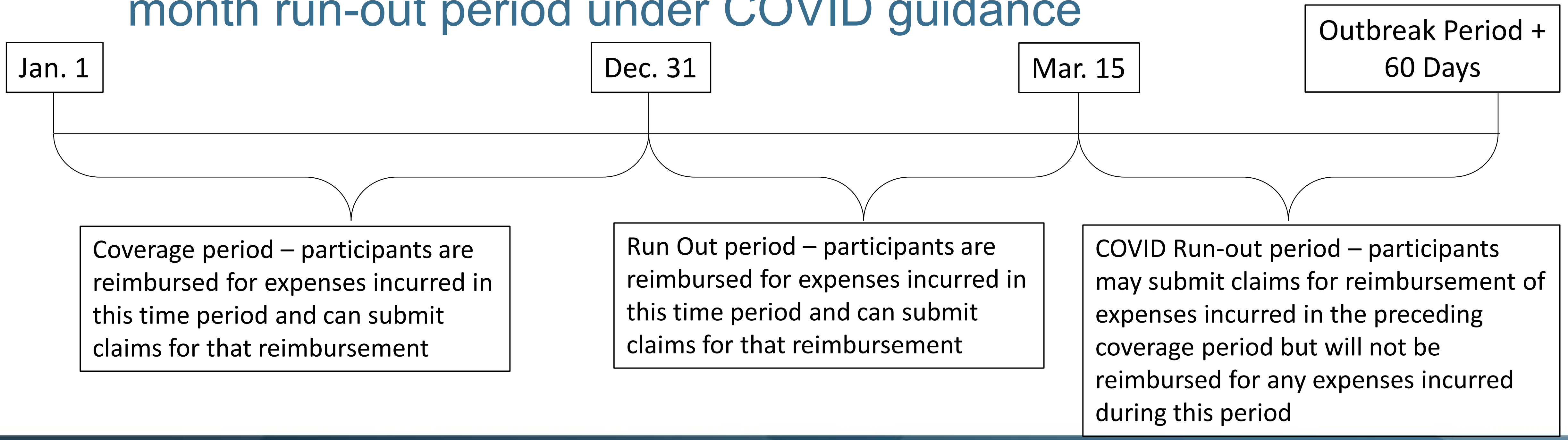
Run-out period – participants may submit claims for reimbursement of expenses incurred in the preceding coverage and grace periods but will not be reimbursed for any expenses incurred during this period

Regulations Issued Extending Claims Submission Deadline – Claims Runout

- The regulations issued on May 4th require ERISA plans to "disregard" the period from March 1, 2020 through the date that is (60 days) after the end of the "Outbreak Period" for claim submission
- Allows an Employer to extend the deadline in which to submit the claim (NOT to incur the claim); essentially, a limited run-out period is added
- Left many unanswered questions

Timeline COVID

- Below is a timeline demonstrating how different periods relate in a plan with a calendar-year, 12-month coverage period and 2½ -month run-out period under COVID guidance

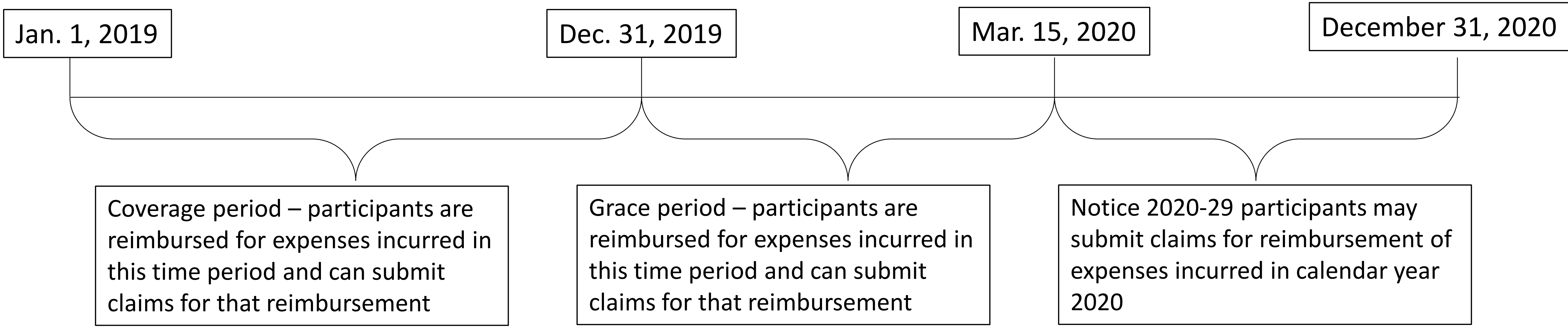


Notice 2020-29 – Grace Periods

- Employers may allow employees to use amounts from their 2019 health FSAs and dependent care FSAs to pay for or reimburse medical or dependent care expenses, respectively, incurred through December 31, 2020
- This applies for any cafeteria plan that has a grace period or plan year ending in 2020
- Does not apply to 2019 calendar year plans that do not have a grace period
- Applies to health FSAs and DCAPs

IRS Notice 2020-29 Extended Claims Period- Grace Period

- Looking at our Timeline: after the grace period ends (or coverage period if no grace period) in 2020, participants may still submit claims for expenses incurred during the coverage period in 2020



IRS Notice 2020-33; Carryover Increase

- Provides a permanent increase to the maximum carryover amount for health FSAs from $500 to an amount equal to 20% of the maximum salary reduction contribution under 125(i) – currently $2,750.
  - 20% of $2,750 = $550
  - For carryovers from 2020 plan years, the maximum carryover amount is $550
- Effective beginning with carryovers from 2020 to 2021, and the amount will be increased each year, just like the max FSA elective contribution amount.

FAQs

- **Do these changes require an amendment?**
  - Yes, an amendment that adopts any or all of these changes must be adopted by December 31, 2021.
- **When does an employer have to decide whether to apply these changes?**
  - Technically, until December 31, 2021, when the amendment is due. Practically, employers need to notify participants ASAP of any coming changes.

FAQs Cont.

- **What restrictions can be put on election changes?**
  - Employers may adopt the changes with any restrictions, including time limits and number of change limits, so long as the restrictions are nondiscriminatory and remain compliant with other applicable laws.
- **Can a participant elect to decrease their contribution lower than what has already been paid out to them?**
  - In order to minimize potential financial exposure, it is advised that an employer limit decreases in elections to an amount no less than the amount that has already been reimbursed this year.

FAQs Cont.

- **How are participants made aware of these changes?**
  - Not only participants, but all employees eligible to participate in the plan should be informed of any changes. Per ERISA regulations, one or more methods of delivery likely to result in full distribution must be used. For most employers, this means using first class mail.
- **Will the plan year dates be extended?**
  - Plan year dates are not affected.
- **Can an election change be back-dated?**
  - No. The IRS has restricted these mid-year election changes to prospective-only.

FAQs Cont.

- **The 2 ½ month Extended Grace Period for my 2019 FSA plan year ended on March 15, 2020. Does this mean I can amend my plan to allow my employees to spend funds remaining in the 2019 FSA plan year until December 31, 2020?**
  - Yes, but proceed with caution if you offer a high-deductible medical plan and health savings account (HSA). As you may be aware, the IRS does not allow participation in a general-purpose health FSA and HSA at the same time. If an employee had any general-purpose health FSA funds remaining on December 31st, they are not eligible to make HSA contributions (both employee and employer) until the end of the grace period (typically April 1st). If you allow participants to incur healthcare expenses through 12/31/20 to be paid from the 2019 plan year, no HSA contributions can be made until 2021.This may be a challenge, given that some participants may have already made HSA contributions in April and May. One option is to exclude current HSA participants from the election change enhancements.
- **How do I inform my participants of these changes?**
  - Not only participants, but all employees eligible to participate in the plan should be informed of any changes. Per ERISA regulations, one or more methods of delivery likely to result in full distribution must be used. For most employers, this means using first class mail. However, the DOL has indicated that if the employees are notified timely via electronic communications, no penalties will be assessed.

FAQs Cont.

- **Will the plan year dates be extended?**
  - Plan year dates are not affected.
- **Can an election change be back-dated?**
  - No. The IRS has restricted these mid-year election changes to prospective-only.
- **Are the election changes in Notice 2020-29 limited to COVID?**
  - No. They apply to all participants.

QUESTIONS

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