

Benefits Insights

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Flexible Spending Accounts

A flexible spending account (FSA) is an account in an employee's name that reimburses the employee for qualified health care or dependent care expenses. It allows an employee to fund qualified expenses with pre-tax dollars deducted from the employee's paychecks. The employee can receive cash reimbursement up to the total value of the account for covered expenses incurred during the benefit plan year and any applicable grace period.

"Use-it-or-lose-it" Rule

As required by the Internal Revenue Service (IRS), an FSA has a "use-it-or-lose-it" provision stating that any unused funds at the end of the plan year (plus any applicable grace period) will be forfeited. When electing an FSA during open enrollment, the employee must specify how much he or she would like to contribute to the FSA for the year. The goal is to choose an amount that will cover medical or dependent care expenses, but that is not so high that the money will be forfeited at the end of the year.

The IRS allows employers to offer an extended deadline, or grace period, of 2 ½ months* after the end of a plan year to use FSA funds. Thus, for a plan year ending Dec. 31, employees would have until March 15 to spend the funds in their FSAs. This provision is strictly optional; the employer must choose to implement it.

In addition, employers may allow participants to carry over up to \$550* in unused funds into the next year. Similar to the grace period rule, this carry-over rule is strictly optional, and employers must choose to implement it. The carry-over provision is only available if the plan does not also incorporate the grace period rule.

Types of FSAs

There are two different types of FSAs: health care accounts and dependent care accounts. An employee can elect to have both types of accounts and contribute separate pre-tax dollars to each. These accounts are kept separate; for instance, an employee could not be reimbursed for dependent care expenses from his or her health care account.

Health Care Accounts

A health care FSA reimburses employees for eligible medical expenses, up to the amount contributed for the plan year. A health care FSA offered through a cafeteria plan must limit the amount of salary reduction contributions that employees can make.

A health care FSA only reimburses employees for money spent on medical care, as defined under Section 213(d) of the Tax Code. Section 213(d) of the Tax Code defines "medical care" to include amounts paid "for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body."

Examples of qualified medical expenses include deductibles and copayments for an individual's health plan. Eye exams, eyeglasses, contact lenses, hearing exams, hearing aids, physical exams and smoking cessation programs are also covered. For a complete list of qualified medical expenses, visit the IRS website.

Dependent Care Accounts

The second type of FSA is a dependent care account. This account can be used to pay for care of dependent children under the age of 13* by a babysitter, day care center, or before- or after-school program. Care for a disabled spouse, parent or child over the age of 12 is also eligible for reimbursement.

Many of the same general rules that apply to health care FSAs also apply to dependent care accounts, such as the "use it or lose it" rule. However, there are some other important differences between the two types of accounts. For dependent care accounts:

- There is an annual limit as to how much an employee can contribute. This amount is \$5,000, or, if lower, the maximum amount that can be excluded from the employee's income under Section 129 of the Tax Code when the employee's election is made;
- The American Rescue Plan Act temporarily raises pre-tax contribution limits for a DCAP for calendar year 2021. For this calendar year, a married employee who files a joint tax return or an unmarried employee may place up to \$10,500 in a DCAP. A married employee who files a separate tax return may place up to \$5,250 in a DCAP.
- The money in a dependent care account is not available until it has been deposited by the employee; and
- Dependent care expenses cannot be reimbursed until they are actually incurred. This can be an issue when child care centers "pre-bill" for services, and employees are required to pay in advance.

For more information on FSA plan design and compliance, contact Weadock and Associates, LLC today.

**Due to the COVID-19 pandemic, Notice 2021-15 from the IRS provides flexibility to employers offering FSAs or dependent care assistance programs. These flexibilities allow employers to:*

- *Provide flexibility for the carry-over of unused amounts from the 2020 and 2021 plan years;*
- *Provide flexibility to extend the permissible period for incurring claims for plan years ending in 2020 and 2021, allowing employers to extend the grace period to 12 months;*
- *Provide flexibility to adopt a special rule regarding post-termination reimbursements from health FSAs, which allows employers to permit employees who cease plan participation during 2020 or 2021 to continue to receive reimbursements from unused amounts through the end of the plan year in which their participation ended;*
- *Provide flexibility for a special claims period and carryover rule for dependent care assistance programs when a dependent "ages out" during the COVID-19 public health emergency. For purposes of determining dependent care assistance that may be paid or reimbursed, the maximum age is increased from 13 to 14 years of age; and*
- *Allow certain mid-year election changes for health FSAs and dependent care assistance programs for plan years ending in 2021.*