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Additional COVID-19 125 Plan and Flexible Spending Account Relief

A new IRS Notice released in late February 2021 further extends an employer's ability to offer additional relief for employees participating in flexible spending account (FSA) programs. Employers can now permit the carryover of unused funds in an employee's health FSA and dependent care FSA from 2020 to 2021 and from 2021 to 2022. New rules also increase the age restriction for dependent care FSAs and permit mid-year FSA election changes through 2021. Employers seeking to provide employees favorable flexibility in their benefits packages must sign a plan amendment documenting the changes from the more restrictive rules now stated in their plan document before the end of the calendar year in which the change is made.

In our earlier article, ["IRS Provides 125 Plan and Flexible Spending Account Relief in Response to COVID-19,"](#) we discussed Notices 2020-29 and 2020-33 (the Prior Notices) which were released by the Internal Revenue Service (IRS) in May 2020. Those Notices allowed (but did not require) employers to amend their Section 125 cafeteria plans to (i) allow participants to make mid-year election changes in 2020 that otherwise would not be allowed, (ii) extend "use-it-or-lose-it" deadlines for flexible spending accounts (FSAs) that end in 2020, and (iii) increase carryover amounts for health FSAs.

On December 27, 2020, President Trump signed the Consolidated Appropriations Act (the Act) into law. The Act contained, among other things, a \$1.4 trillion appropriations package to fund the government through September 30, 2021, a \$900 billion COVID-19 relief package, and a plethora of provisions affecting employee benefit plans. Our earlier article, ["What's in the Longest Bill Congress Has Ever Passed? Employee Benefits Provisions in the Consolidated Appropriations Act,"](#) discussed these provisions in depth. This update will focus on Section 214 of Division EE of the Act as well as Notice 2021-15 (the Notice), which was issued by the IRS on February 18, 2021 to clarify the effects of Section 214.

Section 214 extends the flexibility offered in the prior Notices given the ever-looming COVID-19 pandemic. Section 214 is a multi-layered provision that extends employers' ability to permit mid-year election changes for the 2021 plan year and further extends the "use-it-or-lose-it" deadlines to 2021 as well. Moreover, the Notice provides other relief for dependent care FSAs in the form of a special age limit relief that raises the dependent age from 13 to 14 with relation to qualifying costs.

Carryovers and Grace Period Extensions

Section 214 statutorily provides flexibility for Section 125 cafeteria plans to permit plan participants to carry over unused amounts in a health or dependent care FSA to pay or reimburse expenses in the following year. Section 214(a) codifies the flexibility outlined in the Prior Notices which permitted unused funds in a health or dependent care FSA for the plan year ending 2020 to be used to pay/reimburse expenses incurred in 2021. Section 214(b) extends the flexibility to the plan year ending in 2021 so that carryovers can be made to 2022. The ability to carryover amounts applies to the entire unused balance and is not limited to \$550. As usual, the accounts must be segregated so that the funds in the health FSA are used only for medical expenses and the dependent care FSA funds are used only for dependent care.

Alternatively, Section 214(c)(1) permits an employer to extend the grace period by which unused funds remaining in a health or dependent care FSA as of the end of the 2020 or 2021 plan year must be used. The grace period can be up to 12 months after the end of the plan year. In other words, the unused funds must be used within 12 months of the end of the 2020 or 2021 plan years, as applicable.

Section 214(c)(2) goes a step further. It grants employers the discretion to permit employees who cease participation in the plan due to an event such as a termination to continue receiving reimbursements from the unused health FSA account funds from the 2020 and 2021 plan years for the remainder of the plan year, including any grace period. The employer may limit the unused funds eligible for use during the grace period to the amount of

salary reduction contributions the employee made during the year in which the employee ceased being a participant.

The IRS recognizes that, as a practical matter, the flexibility of Sections 214(a) and (b) provide the same relief as the extended grace period under Section 214(c)(1). The main difference is how employees who cease participating in a plan during one of the affected years can utilize unused funds in their FSA (*i.e.*, whether the unused funds can be used during the grace period via the Section 214(c)(2) structure or lost via the Section 214(b) carryover structure).

If an employer elects to implement any of the relief, an amendment to the Section 125 cafeteria plan document must be implemented. Only one amendment—carryover or grace period—can be implemented. For both structures, unused amounts that are newly eligible for use in the subsequent year are not taken into account when determining the annual contribution limitations the following year. Furthermore, a carryover or grace period for a health FSA will still limit the ability of an individual enrolled in a high deductible health plan from being eligible to contribute to a health savings account, unless the amounts are only available via a limited-purpose health FSA or the individual opts out.

Mid-Year Election Changes

Employers may also permit employees to make mid-year election changes for health and dependent care FSAs for plan years ending in 2021 under Section 214(e). Specifically, employers may permit employees to revoke an election, make a new election, or increase or decrease an existing election in connection with a dependent care FSA in 2021. In regard to health FSAs, employers may permit employees to make a new election on a prospective basis for those who initially declined coverage, revoke an existing election to enroll in a different type of health coverage offered by the employer, or revoke an existing election to enroll in other health coverage. This is an extension of the relief granted in the prior Notices, which permitted the mid-year election changes in 2020.

Dependent Care Age Limit Relief

Traditionally, qualifying costs eligible for reimbursement under a dependent care FSA were those stemming from a child under the age of 13. Section 214(d)(1) of the Act temporarily increases the age to 14, thereby granting relief to employees whose children “aged out” (i.e., reached age 13 during the 2020 plan year) when the funds in their dependent care FSA were essentially unusable due to the COVID-19 pandemic. It is important to note that an employer may amend its Section 125 plan document to encompass the special age limit relief but not the other carryover or grace period relief outlined in Sections 214(a), (b), and (c), or vice-versa.

As noted above and in our previous article, these changes are optional for employers. A plan can be amended to implement all these rules, none of them, or just a few. To adopt one of these changes, an amendment must be adopted before the end of the calendar year in which the change is made.

Please contact [Carl Lammers](#), [Edward Rivin](#), or any attorney in Frost Brown Todd’s [Employee Benefits & ERISA](#) practice group if you have questions about any of the COVID-19-related relief applicable to Section 125 plans.

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