

SAN FRANCISCO HEALTH SERVICE SYSTEM

Affordable, Quality Benefits & Well-Being

ADDENDUM to the Plan Year 2021 San Francisco Health Service System (SFHSS) Section 125 Cafeteria Plan and the 2021 San Francisco Health Service System Member Rules June 10, 2021

Dependent Care Flexible Spending Accounts

Purpose: Under the American Rescue Plan Act (ARPA), signed in to law on March 11, 2021, employers have the option to temporarily increase the annual Dependent Care Flexible Spending Account (DCFSA) maximum contribution from \$5,000 to \$10,500 (\$5,250 for married couples filing separately) for 2021. This provision is only applicable for 2021; it does not apply to any plans in 2022. Under the act, employers will be permitted (but not required) to amend their cafeteria plans to allow changes to their administration of FSAs from the plan year 2020 and 2021.

Revision of 2021 SFHSS Member Rules and Cafeteria Plan: Based on guidance from ARPA, the following changes will be made for Dependent Care FSAs during 2021;

Employees eligible for SFHSS Dependent Care FSAs who earned \$130,000 or less in 2020, can make the following change once: increase contribution up to a maximum of \$10,500.*

Health Care Flexible Spending Accounts

Purpose: On December 27, 2020, the Consolidated Appropriations Act, 2021, H.R. 133(Act) was signed into law. The Act provides for government spending on coronavirus relief, including temporary rules that allow employers to provide additional flexibility for health care Flexible Spending Accounts (FSAs). Under the Act, employers are permitted, but not required, to amend their cafeteria plans to allow changes to their administration of FSAs from the plan year 2020 and 2021.

Revision of Carryover Provision for 2021 SFHSS Member Rules and Cafeteria Plan: Based on guidance under the Act, employers are permitted, but not required, to authorize the carryover of unspent amounts remaining in a Health Care FSA as of the end of a plan year 2020 to pay or reimburse a participant for eligible expenses incurred during the 2021 plan year. This does not include carryover amounts of up to \$500 carried over from 2019 Health Care FSAs to 2020.

*An employer is not required to provide unlimited election changes but may, in its discretion, determine which such election changes are permitted and applied provided, however, that any permitted election changes are applied on a prospective basis only, and the changes to the plan's election requirements do not result in failure to comply with the applicable § 125 cafeteria plan nondiscrimination rules.

Dependent Care Flexible Spending Accounts (DCFSA) and Cafeteria Plan Compliance

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Background

In its January 2021 meeting, the Health Service Board approved the following changes to 2021 Dependent Care Flexible Spending Accounts (DCFSA) as allowed in the Consolidated Appropriation Act, 2021 (H.R. 133) approved by Congress in December 2020;

- (1) employees eligible for San Francisco Health Service System (SFHSS) DCFSA can make the following changes once: revoke an election, make a new election, or decrease or increase an existing election applicable to a DCFSA on a prospective basis without a qualifying event; and
- (2) extend the maximum age of eligible dependents for whom expenses can be incurred from age 13 to 14 as long as the dependent reached the maximum age of 13 during the 2020 plan year;

Under the American Rescue Plan Act (ARPA), signed in to law on March 11, 2021, employers have the option to temporarily increase the annual Dependent Care Flexible Spending Account (DCFSA) maximum contribution from \$5,000 to \$10,500 (\$5,250 for married couples filing separately) for 2021. This provision is only applicable for 2021; it does not apply to any plans in 2022.

Cafeteria Plan Non-Discrimination Testing

On March 24, 2021, the SFHSS DCFSA administrator, P&A, notified SFHSS that the current plan design failed the IRS' non-discrimination regulatory requirements. The IRS' non-discrimination regulation requires that employees earning \$130,000 or less annually must contribute 55% of the total contributed amount of all employees enrolled in an employer's DCFSA plan. This is not uncommon for a large employer. Failing the non-discrimination testing results in an IRS mandated reduction of the elected annual amount for all employees earning over \$130,000. The mandated reduction amount is determined by an IRS formula. The formula determines a percentage to reduce each DCFSA election amount for employees earning over \$130,000.

For example, for 2021 SFHSS DCFSA elections of employees earning over \$130,00, a 2021 election of \$5,000 would be reduced to \$3,975.00. An election of \$2,500 would be reduced to \$1,987.50. An election of \$1,300 would be reduced to \$1,033.50.

Failure on the part of SFHSS to reduce the amounts on employees earning over \$130,000 in compliance with the non-discrimination regulation could result in the total DCFSA election amount of the employees earning over \$130,000 to be taxable.

Cafeteria Plan Compliance

Based on the information above, SFHSS is not recommending that the election amount of DCFSA be increased to \$10,500 because, at the current 2021 maximum of \$5,000, that less than 55% of the total election amount of all employees has been elected by those earning \$130,000 or less. Increasing the election amount would allow those earning over \$130,000 to enroll in a higher amount and would further divide those earning more than \$130,000 from those earning less than \$130,000. Increasing the election amount to \$10,500 would also require additional IRS non-discrimination testing since it failed at \$5,000. This would very likely lead to an increased percentage of reduction in the election of those employees earning more than \$130,000 regardless if they increased their original election amount.

Recommended Solution

SFHSS has confirmed that we can allow two maximum election amounts for DCFSA's. This would allow increasing the election amount for employees earning \$130,000 or less to \$10,500 but keeping the election amount for employees earning over \$130,000 at \$5,000. This is administratively and operationally possible, however, there is an increased burden on SFHSS as it would require new workflows, communications and systems configuration that currently do not exist. SFHSS would also need to perform the Non-Discrimination test again later in the year to ensure compliance with the Cafeteria Plan non-discrimination regulations. However, it is likely that allowing employees earning \$130,000 or less to increase their enrollment above \$5,000 would improve the results of the initial Non-Discrimination test by allowing the HSS FSA plan to reach or come closer to the requirement that 55% of total DCFSA deductions come from employees earning \$130,000 or less. This would in turn increase the likelihood that employees earning over \$130,000 could reach their original FSA election amount.