

# Quick Decision Needed if Employers Want to Allow Health Flexible Spending Account Carryovers to 2014

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New guidance from the IRS requires plan sponsors to make a quick decision about whether to allow employees to carry over to 2014 up to \$500 in unused amounts in their 2013 health flexible spending accounts (FSAs). Participants are often scrambling to incur medical expenses by year-end in order to use up their health FSA contributions. Otherwise, any unused amounts must be forfeited under the "use it or lose it" rule (possibly subject to a grace period). Now IRS Notice 2013-71 modifies the "use it or lose it" rule and allows plan sponsors to amend their cafeteria plans for up to \$500 in carryovers to the next year.

The rule only applies to plans that are amended to permit the carryover. To implement the rule, a plan generally must be amended on or before the last day of the plan year from which amounts may be carried over (so by December 31, 2014 for a 2014 carryover to 2015, for calendar year plans). Under a special transition rule for 2013 contributions, the actual plan amendment does not have to be adopted until the last day of the plan year that begins in 2014 (so by December 31, 2014 for calendar year plans), as long as the plan is operated in compliance with the guidance.

The \$500 carryover rule is only allowed in a plan that does not have a "grace period." A grace period is a period of up to 2-1/2 months of additional time after the end of the year during which a participant can incur expenses and be reimbursed from contributions for the previous year. Thus, if a plan has a grace period and wishes to utilize the new carryover rule, the plan must be amended to eliminate the grace period. Because of that, an employer with a plan that currently has a grace period would likely not want to implement the new \$500 carryover rule until at least the 2014 year for carryover to 2015.

An advantage of using the grace period rule when compared to the new carryover rule is that the grace period amount is not limited to \$500. For example, a participant who elected a \$2,500 contribution in 2013 but only incurred \$1,000 in medical expenses by the end of the calendar year would be reimbursed for the remaining \$1,500 for medical expenses incurred by March 15, 2014 (assuming a calendar year plan that allows the full permitted grace period). In contrast, under the new carryover rule, the participant would be limited to carrying over \$500. However, a disadvantage of the grace period rule as compared to the new carryover

rule is that as noted, under the grace period rule, the expenses must be incurred by March 15, 2014, for calendar year plans. In contrast, under the new rule, the expenses could be incurred at any time during 2014 for calendar year plans.

Employers should also consider the following in determining whether to adopt the new carryover rule:

- Use of the carry over feature does not affect the overall annual salary reduction limit available to participants. In other words, a participant may still elect annual salary reductions of up to \$2,500 (or any lesser amount provided under the plan), as well as carry over up to \$500 from the prior plan year. Thus, a participant could have \$3,000 available in a health FSA for expenses incurred during the next plan year.
- The amount available for carryover to the next year is determined after all expenses have been reimbursed during the plan year run-out period (i.e., the period for submitting claims incurred in the prior year) and after any applicable grace period that applied for the prior year.
- This new guidance does not comment on the interplay between amounts carried over from a general purpose health FSA and eligibility for health savings account (HSA) contributions (in conjunction with a high deductible health plan) for the next year. Therefore, it appears that coverage under the \$500 carryover rule (of either the participant or the participant's spouse) would disqualify the employee from making HSA contributions. This result may be able to be avoided by designing the carryover as a limited purpose health FSA carryover (e.g., for dental expenses) or allowing the participant a choice between a limited purpose and general purpose FSA carryover, if allowed by the IRS.
- Given the timing of this guidance it might be impractical for employers to change their open enrollment materials and communicate a change at this late date in the year. Also, although a change for carryovers from 2013 could help employees who currently have amounts remaining in 2013, such a carryover could complicate their 2014 benefit elections if they've elected an HSA, and might even change their desired elected health FSA election amounts for 2014. Even for a change allowing 2014 elections to be carried over to 2015, employees might want to change their 2014 elections, and any grace period elimination could also affect elections. If employers have already closed their open enrollment period, they may want to consider reopening the period, perhaps restricted to health FSA changes.

Notice 2013-71 makes another change to cafeteria plans as well for employers with non-calendar year cafeteria plans. Those employers can amend their cafeteria plans to permit a one-time prospective mid-year election or change of a salary reduction election or a one-time prospective mid-year revocation of an election with respect to accident or health plan coverage. This optional change is intended to account for employees who might make a change in health coverage due to enrolling in coverage

under one of the health care reform Exchanges.

For questions regarding the new "use it or lose it" rule modification, or any other benefits question, please contact a member of Holland & Hart's Benefits Law Group.

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