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ALERTS!

Health Care FSA Eligible for $500 Rollover Now

The Internal Revenue Service (IRS) has decided to let holders of Health Care flexible spending arrangements (FSA) roll over up to $500 in account balance from one year to the next without worrying about the infamous "use-it-or-lose-it" rule.

On October 31, 2013, the IRS issued Notice 2013-71 (look here to read) and they also talk in the notice about how they will make the change available to workers at employers with non-calendar plan years. **The change takes effect immediately.**

Background

FSAs give workers a vehicle for setting aside cash to pay for health care expenses without paying income taxes on the cash.

The IRS tried to discourage high-income workers from using FSAs as investment accounts by requiring them to forfeit any unused cash at the end of the plan year. The employers got to keep any cash forfeited.

In 2005, the IRS tried to ease the burden the rule caused by creating a grace period. The grace period rule gave FSA holders the ability to avoid losing FSA cash by using the cash up to two months and 15 days after the end of the plan year.

In 2010, the drafters of the Patient Protection and Affordable Care Act (PPACA aka ObamaCare) tried to generate revenue to cover part of the cost of PPACA by capping the deductibility of FSA contributions at $2,500 per year.

IRS officials noted in 2012, in **Notice 2012-40**, that because PPACA capped tax deductible contributions at $2,500 per year, the FSA could no longer be much of a tax shelter for the wealthy.

When officials asked for comments on changing the use-it-or-lose-it rule in that notice, commenters said a change could simplify health FSA administration, and make FSA programs more attractive to low-income and moderate-income workers, who "are more reluctant than others to participate because of aversion to even modest forfeitures of their salary reduction contributions," officials said.

IRS officials said they believe a $500 rollover cap is appropriate because most FSA forfeitures are for less than $500.

An employer cannot offer a FSA carryover provision and an FSA grace period at the same time.

To adopt the change, an employer must add a carryover provision to the FSA plan document and eliminate any grace period provision, officials said.

What You Need to Know & Do Now

Employers make the choice to either offer the 2.5-month extension or the $500 rollover option. And, you can amend your 2013 (current plan) to allow the rollover option before December 31, 2013. If you don't have a calendar year plan, you may amend your existing plan any time prior to the end date.

- Applies to 2013 plan years and of course the 2014 plans.
- Applies only to Health Care FSAs; Dependent Care FSAs still have the use it or lose it rule.
- Groups with existing FSAs that want to replace the 2.5-month extension with this new rollover option need to amend the plan.
- Does not affect the $2,500 maximum contribution currently in place. In other words, the employee could contribute $2,500 in 2014, carryover $500 from 2013, giving them $3,000 for the 2014 plan year.
- The $500 rollover may be used for expenses incurred in the new plan year (e.g., 2014) as well expenses from the previous plan year. The notice creates more flexibility and more time for participants to spend their flex dollars. They're no longer limited to just 2.5 months.
- Employer is not required to offer the carryover or the 2.5-month extension.

We expect that the Third Part Administrators, who process the claims, are going to need some minor development time, during the next 60-75 days, to modify their system to accommodate the new rollover option. So, if you choose to amend your 2013 plan, the carryover amounts may not show up in your TPA's system right away.

If you would like some help in addressing this issue, or any other employee benefit issue, please call us so that we can discuss your concerns and how we may be of service.