

“Use-or-Lose” Rule

Employees who participate in a health flexible spending account (FSA) are required to make a salary deferral election at the beginning of the plan year. Employees can use the money in the account to reimburse any qualified medical expenses not covered by their health plan including deductibles, copays and dental and vision expenses. Salary deferrals are made on a pre-tax basis. In exchange for the tax benefit, employees have been subject to a “use-or-lose” rule that means they forfeit any unused amounts at the end of the plan year. This rule has prevented many employees from participating in the health FSA.

Employers now have the option to allow employees to carryover up to \$500 of their unused health FSA amounts into the next plan year rather than losing the entire balance. The new carryover provision does not impact the maximum amount an employee can contribute to a health FSA. Employees may still contribute up to the current maximum of \$2,500.

For example: If an employee has \$750 of unused funds at the end of the claims submission period for the 2013 plan year, \$500 may be carried over into 2014 and only \$250 is forfeited. This means the individual would have up to \$3,000 to reimburse 2014 medical expenses.

It is important to note that employers are not required to include the new carryover rule into their plan. Employers also have the option of specifying a carryover amount that is lower than \$500.

Employers that wish to incorporate the new carryover provision in their health FSA plan will need to amend their plan accordingly. Employers have until the last day of the plan year in which amounts will be carried over to amend their plan (as long as participants are informed of the provision and the plan is operated in compliance with the new rules). This means that a calendar year plan allowing amounts to be carried over from 2013, must be amended no later than December 31, 2014. For plans that include a 2 ½ month extension allowing for the reimbursement of claims incurred and submitted in the next plan year, employers must choose either the extension or carryover. Plans may not include both a carryover provision and a 2 ½ month grace period. If an employer must also amend its plan to remove any existing grace period, the amendment must be adopted no later than the end of the plan year from which amounts may be carried over.

The new rules are intended to give employees more flexibility in how they pay for health care and to encourage participation in health FSA plans. However, whether to implement the new carryover provision is a matter of plan design for employers and not a matter for employees to decide. Employers will need to evaluate whether or not this provision fits into their overall package of benefits offerings.

Marketplace Coverage and Mid-Year Changes for Non-Calendar Year Plans

In addition to amending the “Use or Lose” rule, Notice 2013-71 provides additional guidance on the impact of marketplace coverage on non-calendar year Section 125 plans. Section 125 cafeteria plan elections must be made before the plan year and may not be changed during the plan year unless there is an allowed change in status. The IRS does not recognize the availability of marketplace coverage as a change in status.

In previous guidance, the IRS stated that it would allow employers with non-calendar year Section 125 plans to amend their plans allowing mid-year election changes to allow individuals to move from the plan to the exchange, from the exchange to the plan or both on January 1, 2014. Because this guidance was issued with large employer shared responsibility rules, it was unclear whether or not it was also applicable to small employers (employers with less than 50 employees). The IRS has not clarified that this option is available to employers of all sizes with non-calendar year plans.

Please contact your HORAN Account Manager or Client Specialist for additional information.

The information contained in this document is informational only and is not intended as, nor should it be construed as, legal or accounting advice. Neither HORAN nor its consultants provide legal, tax nor accounting advice of any kind. We make no legal representation nor do we take legal responsibility of any kind regarding regulatory compliance. Please consult your counsel for a definitive interpretation of current statute and regulation and their impact on you and your organization. Thank you.