



IRS MODIFICATION OF FSA “USE OR LOSE” RULE

American Benefits Council P4P ...
“Preparing for PPACA” Webinar

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- Allows optional adoption of \$500 (or less) carryover for Health FSA (not DCAP)
 - Carryover does not reduce \$2500 salary reduction amount in the following year
 - Must be uniformly available
 - In lieu of grace period
 - “Uniform Coverage” rule is not modified
- Significant departure from IRS’s historic position that “use or lose” is necessary to avoid prohibited deferral of compensation.

Pros and Cons of Adopting Carryover

Pros

- Increased participation of employees (FICA savings)
- Ending wasteful end-of-year spending

Cons

- Loss of forfeitures
- Some additional administration
- Requires cancellation of grace period
- Some HSA complications

Grace Period vs. Carryover

Grace Period

- Applies to entire Account Balance
 - Participants who planned for large expenditure during Grace Period won't lose contributions

Carryover

- Duration not limited
- Reduces financial risk of loss for participants with favorable health experience and low claims

Amendment Timing

- Could be effective for 2013
 - Must announce before end of plan year
 - Must amend plan before end of plan year beginning in 2014
 - If grace period, must amend plan before plan year-end to eliminate grace period
 - Address any non-Code legal constraints

HSA- Eligible Individual Status

- General Rule
 - Individuals with non-HDHP coverage are not HSA-eligible (i.e., not able to make monthly contribution)
- Exception
 - Does not apply to “permitted insurance,” including accident and critical illness, “permitted coverage,” including dental/vision and coverage for preventive care
 - Rev. Rul. 2004-45 addresses FSA/HRA and HSA interaction
- Grace Period impacts HSA eligibility
 - Code § 223 provides exception for those with zero balance on last day of plan year (e.g., 12/31), measured on cash basis

HSA- Eligible Individual Status

- Carryover to general purpose FSA would impact HSA eligibility
- Possible work-arounds:
 - Allow waiver of carryover
 - Preclude carryover for those who enroll in HSA
 - Convert carryover to limited purpose or post-deductible FSA

Administrative Issues

- Coordination with runout period
 - Carryover determined after any “run-out” period claims (Example 1)
 - Ordering rule: may want to reimburse current year claims from current year salary reductions first (Example 2)
- Carryover is indefinite (Example 4)
 - Unless terminate employment
 - Can employer end carryover if participant has no claims for more than one year?
- Could be capped at less than \$500
 - But must be uniformly applied

Administrative Issues

- Required FSA participation in the next plan year
 - Can the employer require a minimum salary reduction election in the next plan year?
- Minimum carryover amount
 - Example – can only carryover amounts \$10 and over

Questions

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