Keenan HealthCare

BRIEFING

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HEALTH FLEXIBLE SPENDING ARRANGEMENTS $500 CARRYOVER AND MORE

On October 31, 2013, the IRS released Notice 2013-71 (http://www.irs.gov/pub/irs-drop/n-13-71.pdf) which eases the "use-or-lose" rule of Health Flexible Spending Arrangements (Health FSAs). As a result, effective immediately, a cafeteria plan may be operated to allow participants to carryover up to $500 of unused amounts remaining in a Health FSA into the next plan year. The new provisions are subject to certain rules and conditions as described below.

Q. Will a carryover impact the $2,500 maximum amount of salary reduction for a following Plan Year?

A. No. The carryover will not impact the maximum amount of salary reduction for a following Plan Year. However, a cafeteria plan that adopts this new carryover rule must not also provide a Health FSA Grace Period.

Q. What is a "Grace Period"?

A. Traditionally, Health FSAs have a use-or-lose rule whereby amounts not used for qualified medical expenses by the end of the Plan Year (Unused Amounts) were forfeited. Some plans have adopted a Grace Period whereby a participant may apply Unused Amounts toward expenses incurred after the close of the Plan Year for up to two months and 15 days following the close of the Plan Year. This is different than the "Run-Out Period" which allows a participant to submit claims following the close of the Plan Year for expenses incurred before the close of the Plan Year. Typically, a Run-Out Period is a three month period following the close of a Plan Year or Grace Period.

Q. What is the difference between this new $500 carryover rule and having a Grace Period?

A. The new carryover rule allows up to $500 of Unused Amounts to be carried over and used for the entire following Plan Year. A Grace Period allows all Unused Amounts, even amounts above $500, to be carried over and used for claims incurred in the following Plan Year but only for two months and 15 days.

Q. Must a sponsor permit the carryover of $500?

A. No. This decision is entirely at the option of the sponsor. Moreover, a sponsor may set a threshold lower than $500 of Unused Amounts or, alternatively, just keep the Grace Period.

Q. What other conditions has the IRS included within this rule?

A. In addition to eliminating a Grace Period, if any, the Unused Amount carried over must apply to all participants, not be cashed out and not be converted to any other taxable or nontaxable benefit. Moreover, Unused Amounts must only be used for qualified medical expenses (excluding health insurance, long-term care services or insurance).

Q. How is the $500 carryover amount administered?

A. For ease of administration, it is recommended that administrators pay claims from the Carryover Amount first and then, only after exhausting the Carryover Amount, from current year contributions. Claims submitted during a Run-Out Period but in respect of the prior plan year would reduce the amount of the carryover.

Q. Can we implement the Carryover for this Plan Year?

A. Plans that wish to take advantage of this new carryover option for the Plan Year beginning in 2013 must adopt an amendment to their cafeteria plan on or before the last day of the Plan year beginning in 2014 (2013 if the plan has a Grace Period), provided that the plan operates in accordance with the IRS guidance immediately and informs participants of the carryover provision.

Should you have any questions regarding this Briefing, please contact your Keenan representative.