ISLER DARE RAY RADCLIFFE & CONNOLLY, P.C.

EMPLOYEE BENEFITS UPDATE

July 2012

Health Flexible Spending Accounts Must Be Amended to Reflect $2,500 Limit Taking Effect in 2013

Executive Summary

- Beginning in 2013, health flexible spending accounts (health FSAs) must limit the amount of employee salary reduction contributions to $2,500.
- Employer contributions, flex credits, and pre-tax payments of health insurance premiums will not count against this limit, which will be increased for inflation in future years.
- Plan amendments must be done by the end of 2014.

What You Should Do

- Contact your FSA vendor to make sure that they will be able to implement this change, operationally, for 2013.
- Include this change in your open enrollment guides for the 2013 year.
- Amend your FSA plan document no later than the end of 2014.

As part of the Federal health reform law, health flexible spending accounts (health FSAs) must limit the amount of salary reduction contributions each participant can make in 2013 to $2,500.

Recently, in Notice 2012-40, the IRS clarified several key requirements about this new change:

- The $2,500 limit first applies for plan years that begin after December 31, 2012. Therefore, if your health FSA runs on a non-calendar fiscal year, it may be able to defer implementation of this change (at least for a few months).
- The $2,500 limit applies only to pre-tax salary reduction amounts contributed by an employee to his or her health FSA. Employer contributions or flex credits are not subject to this limit, nor are pre-tax payments of an employee's share of health insurance premiums.
- The $2,500 limit will be indexed for cost of living adjustments for plan years beginning after December 31, 2013.
- If a health FSA has a short plan year (fewer than 12 months) after 2012, the $2,500 limit must be prorated based on the number of months in the short plan year.

- The health FSA will need to be amended in writing, no later than the end of 2014.
- If a health FSA provides a grace period where unused salary reduction contributions can be carried over into the next year, those carried-over amounts for the prior year will not count against the $2,500 limit for the subsequent year.
- The $2,500 limit does not apply to salary reductions or other contributions to a health savings account or amounts made available by an employer under a health reimbursement account.
- The $2,500 limit does not apply to salary reduction contributions to a dependent care FSA (which are typically limited to $5,000).

The future of the "use it or lose it" rule

IRS has asked for comments on the "use it or lose it" rule, in light of the $2,500 limit.

The "use it or lose it" rule generally prohibits any contribution or benefit under an FSA from being used in a subsequent plan year – in other words, amounts which are not used are forfeited at the end of the plan year. Because the $2,500 limit effectively reduces the potential for using health FSAs to defer compensation, IRS is considering whether the "use it or lose it "rule should be modified.

In a similar way, legislators in the US Congress have been battling over different bills that could amend or substantially limit the "use it or lose it" rule. At this time, these efforts have not been enacted into law; however, they may be an indication of future changes to come in the FSA world.

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If you have any questions about these new developments in particular, or about your benefit plans in general, please let us know.

ISLER DARE RAY RADCLIFFE & CONNOLLY, P.C.
1945 Gallows Road, Suite 650
Vienna, Virginia 22182
703-748-2690

Andrea I. O'Brien
aobrien@islerdare.com

Vi D. Nguyen
vnguyen@islerdare.com