

Insights, News & Events

# FLEXIBLE SPENDING ACCOUNT RULES WILL NOW ALLOW A \$500 ANNUAL CARRY OVER

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The IRS handed health care flexible spending account participants an early Christmas present on Halloween when it modified cafeteria plan “use-it-or-lose-it” rules so that \$500 can be carried over from one year to the next in Flexible Spending Accounts (FSA).

Under Notice 2013-71, these accounts may now be modified so up to \$500 can be carried over to defray qualifying medical costs in the next year. The rule change followed sharp criticism of the “use-it-or-lose-it” requirement, and concerns that participants were undergoing unnecessary medical procedures at the end of the year to avoid forfeiting account balances.

But the IRS gift comes at a price.

Cafeteria plans that wish to take advantage of the new rule may not use a “grace period,” which has been a popular feature in many FSAs, allowing participants to use prior year account balances to pay for expenses incurred in a following year during the first two and one-half months of that year.

## **Written plan amendment required**

To take advantage of the new rule, plans must be amended in writing. A special transition rule allows an amendment to be made in 2014, effective as of the beginning of a plan year beginning in 2013.

And, if a plan contains a grace-period provision and wants to allow the carryover, the grace-period must be amended out of the plan at the same time. The IRS warned that such

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retroactive amendments were OK as far as it was concerned, but that other laws might be problematic.

### **Prior run-out rules still effective**

The IRS was careful to point out that even though grace periods cannot be used in conjunction with the new rule, “run-out” periods are still allowed.

A “run-out” provision allows a participant to use funds from a prior year during the first few months of the next year, but only to defray qualifying expenses incurred in the prior year. By contrast, “grace periods” allow funds from a prior year to be applied against expenses incurred in the first few months of the next year.

### **Contribution limits not affected**

Health care reform ushered in a new \$2500 limitation on health care flexible spending accounts effective in 2013. The IRS noted that this \$2500 limit is not affected by the new rules.

In other words, a participant can carryover up to \$500 and still elect a full \$2500 deferral in a following year.

### **Other changes**

IRS Notice 2013-71 also provides welcome relief in other areas for non-calendar year cafeteria plans. Under the Notice, participants in these plans are now allowed to make a one-time mid-year election change to salary reduction arrangements used to pay pre-tax plan premiums, without regard to a change in status.

Employers are allowed to amend their plans so that a participant can prospectively revoke or revise his or her election, or, if the individual failed to make an election, prospectively elect a deferral. This change was made so that participants can take advantage of health coverage offered through state or federal exchanges, without concern about prior elections (or non-elections) under cafeteria plans.

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