



# **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 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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