

A banner image showing a stethoscope resting on an American flag. The text "What Employers Need to Know Right Now About Health Care Reform" is overlaid on the image.

## What Employers Need to Know Right Now About Health Care Reform

### **IRS Liberalizes the Health Flexible Spending Account “Use It or Lose It” Rule**

On Oct. 30, 2013, the Internal Revenue Service issued a notice that liberalizes the “use it or lose it” rule that applies to health flexible spending accounts (HFSA) and clarifies that employers of all sizes may choose to amend their Section 125 plan to essentially treat the availability of the health marketplaces/exchanges as a one-time change in status event.

#### **Use It or Lose It**

Under the new rule, a plan may – but is not required to – allow participants to carryover up to \$500 in unused contributions to the next plan year. The \$500 carryover does not count against the maximum employee contribution to an HFSA of \$2500 per year.

Example: Smith Corp. has a calendar year plan and a runout period that ends March 31. Jane elects an HFSA salary reduction of \$2,500 for 2015. On Dec. 31, 2014, Jane’s unused amount for the year is \$800. On Feb. 1, 2015, Jane submits claims and is reimbursed with respect to \$350 of expenses incurred during the 2014 plan year, leaving a carryover on March 31, 2015 (the end of the run-out period), of \$450 of unused HFSA amounts from 2014. The \$450 is available as carryover in 2015 so that \$2,950 (\$2,500 + \$450) is available to pay claims Jane incurs in 2015.

Any amounts that are unused by the end of the runout period and that exceed \$500 must be forfeited. Unused carryover amounts also must be forfeited if the participant terminates employment (unless the participant elects COBRA).

Example: Smith Corp. has a calendar year plan and a runout period that ends March 31. Bill elects an HFSA salary reduction of \$600 for 2014, but submits no claims in 2014. Bill may carry over \$500 to 2015, but \$100 must be forfeited. Bill makes no election for 2015, but has the \$500 carryover amount available. Bill submits \$200 in claims in 2015, leaving \$300 which may be carried into 2016.

If the employer chooses to offer the carryover option, the amount that is carried over must be available throughout the plan year. The employer may allow a carryover amount of less than \$500 but it must make same carryover amount available to all plan participants.

Carryover amounts may be used for either current or prior year expenses. New contributions may only be used for current year expenses (unless carried over to the next plan year). An employer may – but is not required to – design the plan so that current year contributions are used before carryover contributions.

A plan may have either a grace period or allow carryover, but it cannot allow both methods of extending the claims period for the same plan year. This presents a choice between allowing a limited amount (\$500) to be available for the entire year through a carryover provision or allowing a potentially larger amount to be available only during the 2-1/2 month grace period under a grace period provision. The size of the average forfeiture may drive this decision. Due to reliance issues, it may be difficult for plans that currently have a grace period to implement carryover for unused 2013 contributions, but that option certainly will be available for unused 2014 contributions for employers that prefer this alternative.

A plan that chooses to offer the carryover option must amend the plan to include this by the last day of the plan year from which amounts will first be carried over. However, a special rule allows a plan that begins in 2013 to wait until the end of the 2014 plan year to adopt the amendment. If the plan offers a grace period currently, the grace period must be removed in the amendment that adds the carryover provision.

### **Mid-Year Changes for Non-Calendar Year Plans**

The IRS does not consider the availability of the health exchanges/marketplaces a change in status event that would allow an employee to make a mid-year change. However, the IRS has said that it will allow an employer with a non-calendar year plan to amend the plan to allow employees to make mid-year election changes to move from the plan to the marketplace, to allow employees who previously declined coverage to enroll in the plan as of Jan. 1, 2014, or both. (Because coverage purchased in the marketplace will be effective Jan. 1, 2014, calendar year plans should not have this issue.) There had been some question about whether this option was only available to large employers; the IRS has now clarified that employers of all sizes may amend their plan to allow for mid-year changes because of the new marketplace coverage.

The IRS has delayed the individual shared responsibility requirement for individuals who are eligible for coverage under an employer-provided non-calendar year group health plan to the start of the employer's 2014 plan year, so obtaining coverage by Jan. 1, 2014, is not as urgent as previously thought. Employers may still wish to allow employees to enroll in their plan mid-year, and with the required plan amendment (most likely to both the Section 125 and group health plans) this will be allowed. An employer considering a mid-year enrollment option may want to get the approval of its insurer or reinsurer before offering this opportunity – insurers are not required to allow mid-year enrollment.

Read the full text of [IRS Notice 2013-71](#).

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