

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION ALERT

December 2013

IRS Announces New Carryover Rule for Health Flexible Spending Arrangements

Recently, the IRS announced that, effective as of the first day of the first plan year beginning on or after January 1, 2013, participants contributing to a Code Section 125 plan (also known as a “cafeteria plan”) health flexible spending arrangement (“FSA”) will be permitted to carry over certain unspent FSA amounts from one year to the next.

Before the IRS announcement, the rules governing health FSAs provided that any unused contributions to a health FSA that remained at the end of the applicable plan year would be forfeited, subject to a short two and a half month grace period extension if provided under the plan document.¹

The IRS has recently announced that, to the extent provided in plan provisions, up to \$500 of unused health FSA contributions may be carried over by plan participants from year to year. The carryover is not counted against, nor will it otherwise affect, the \$2,500 contribution limit.

In order to allow participants to take advantage of the new health FSA carryover rule: i) a plan sponsor must amend its cafeteria plan to include a carryover provision; ii) the amendment must be adopted on or before the last day of the plan year from which unused amounts are to be carried over; and iii) to the extent such an amendment is adopted, the plan sponsor must notify plan participants. An amendment allowing for carryovers may be effective retroactively to the first day of the plan year, and the carryover limit must be identical for, and apply to, all plan participants.

Notwithstanding the general rule for amending a plan to allow health FSA carryovers, the IRS has announced that a plan sponsor will have until the end of its 2014 plan year to amend its cafeteria plan with respect to carrying over amounts from the 2013 plan year.

Lastly, a cafeteria plan that allows for a grace period is prohibited from implementing a carryover. Therefore, if a plan sponsor intends to amend its cafeteria plan to permit health FSA carryovers, it must remove any grace period provisions by the end of the plan year from which amounts may be carried over.

If you have any questions concerning the FSA carryover, or if you need any assistance in preparing an amendment to permit the carryover, please contact us.

¹ Under the IRS’s “grace period” rule, a cafeteria plan may permit an employee to use any unused FSA amounts remaining from the immediately preceding plan year to pay for certain qualified expenses within the first two and a half months of the current plan year.

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This edition of the Employee Benefits & Executive Compensation Alert highlights recent guidance published by the IRS announcing a new health FSA carryover rule. The Alert was written by Devin M. Karas, a member of the Employee Benefits & Pension Practice Area at Reid and Riege, P.C. The Practice Area works closely with clients to design and draft tax-qualified and nonqualified retirement plans. For information or additional copies of this Alert, or to be placed on our mailing list, please contact Devin (tel. 860-240-1063) (e-mail dkaras@rrlawpc.com) or another member of the Practice Area, John J. Jacobson, Chair (tel. 860-240-1006) (e-mail jjacobson@rrlawpc.com), John V. Galiette (tel. 860-240-1009) (e-mail jgaliette@rrlawpc.com), Ronald J. Koniuta (tel. 860-240-1034) (e-mail rkoniuta@rrlawpc.com), or Erik M. Sharp (tel. 860-240-1074) (e-mail esharp@rrlawpc.com), or the Reid and Riege attorney with whom you regularly work.

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