

On October 31, 2013, the U.S. Department of the Treasury and the IRS issued a notice modifying the longstanding “use-or-lose” rule for health flexible spending arrangements (FSAs). For the first time, at the employer’s option, employees participating in health FSAs will be allowed to roll over — instead of forfeiting — up to \$500 of unused funds remaining at year-end.

Previously, the “use-or-lose” rule provided that health FSA funds not applied toward eligible expenses incurred by the end of the plan year, or by the end of a two-and-a-half-month grace period following the close of the plan year, must be forfeited rather than rolled over for use in subsequent plan years.

What does the modification permit?

The modification permits, but does not require, an employer to amend a cafeteria plan to allow participants to roll over unused health FSA funds of up to \$500 and apply those amounts toward qualified medical expenses incurred during the following year. The rollover is an alternative to the grace period. An employer cannot offer both a grace period and the rollover.

Are the rollover funds counted toward the \$2,500 FSA plan year maximum for the following year?

No. The rollover funds are not counted toward the \$2,500 limit on salary reduction contributions for the following plan year. The rollover amount is in addition to the \$2,500 FSA plan year maximum on employee contributions.

How long does an employee have access to the unused health FSA funds if an employer elects the rollover option?

If an employer that sponsors a health FSA chooses to allow participants to roll over unused health FSA funds, participants can apply those amounts towards qualified medical expenses incurred during the following year.

When does this modification take effect?

Employers who want to offer the rollover option must amend their cafeteria plan documents to permit the rollover, and, where applicable, eliminate the grace period. The amendment must be adopted on or before the last day of the plan year from which the funds may be rolled over and may be effective retroactive to the beginning of the plan year. Therefore, employers wishing to adopt the rollover option for the 2013 plan year have until December 31, 2014, to amend their cafeteria plan documents.

What if an employer offers an HSA with a health FSA?

The notice published by the IRS on October 31 did not specifically address how this impacts a participant’s eligibility to make HSA contributions. Additional guidance will be required from the IRS before SelectAccount can implement this option.