FSA Use-It-or-Lose-It-Rule Modified

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Health flexible spending accounts (FSAs) are becoming more flexible. New federal guidance permits employers to allow workers to carry over unused amounts of up to $500 for expenses in the next year and still contribute up to $2,500 annually.

FSAs are voluntary account-based plans that enable millions of Americans to use pretax dollars to pay for eligible out-of-pocket health care expenses like prescription drugs, co-pays, and vision and dental costs. FSAs are often funded by employees, although companies can also make contributions. However, for nearly 30 years, employees eligible for health FSAs have been subject to the use-or-lose rule, meaning that any account balances left at the end of the year were forfeited, usually to the employer.

Although an estimated 14 million American families participate in health FSAs, the use-it-or-lose-it rule has often been identified as the biggest deterrent for those considering whether to sign up for an FSA.

In 2012, the U.S. Internal Revenue Service requested comments regarding possible modifications to the year-end forfeiture of FSA balances. However, the announced change—coming in the middle of the fall 2013 open-enrollment season—caught plan sponsors and the benefits community by surprise.

Grace Period or Limited Rollover—Not Both

On Oct. 31, 2013, the U.S. Treasury Department and the IRS issued **a notice** and **fact sheet** announcing the change. According to the guidance:

- **Effective in plan year 2014,** employers that offer FSA programs will have the option of allowing participants to roll over up to $500 of unused funds at the end of the plan year.

- **Effective immediately,** employers that offer FSA programs that do not include a grace period will have the option of allowing workers to roll over up to $500 of unused funds at the end of the 2013 plan year.

Under current law, plan sponsors have the option of allowing employees a grace period of up to two and a half months after the year ends to use remaining funds for qualified FSA expenses.

Some plan sponsors may be eligible to take advantage of the option to adopt a carryover provision as early as plan year 2013, according to the notice. In addition, plan sponsors may continue to give employees a grace period. However, a health FSA cannot offer both a carryover and a grace period; it may provide just one of the options or neither.

“A health FSA can have this carryover feature, or a grace period, but not both. The plan must be amended before the end of the year to implement the carryover feature,” emphasized **an analysis** posted by benefits law firm Bryan Cave LLP.

“If the employer would like to adopt the carryover option, they will need to adjust their plan documents before the end of the current plan year,” Joe Jackson, CEO of benefits administration firm WageWorks, concurred in a response to *SHRM Online*.

In other words, employers can opt in to allow the $500 carryover for this year but would have to amend their plans, eliminating the grace period (if they offer one). Since open enrollment is already underway at many companies, amending plans and communicating these changes to employees during this year's open enrollment period could be challenging.

“Since it cannot coexist with the grace period in the same plan, plan sponsors will have to decide which feature is more beneficial to their participants,” according to Bryan Cave's posting. “For example, if most participants elect around $500 for the FSA, the carryover feature may be more beneficial than the grace period."

Plan sponsors will have to decide which feature–the carryover or grace period–is more beneficial to participants.

While the Bryan Cave analysis notes that "a health FSA can have this carryover feature," but "the carryover feature does not apply to other kinds of FSAs," Jackson clarified that the $500 carryover amount "can be applied to any *health care* FSA, including a limited purpose FSA which may complement a health savings account (HSA)."

The guidance isn't the only recent change to FSAs. As of January 2013, the Affordable Care Act capped FSA contributions at $2,500 and excluded over-the-counter medications as reimbursable expenses without a doctor's prescription.

The new $500 carryover won't reduce the $2,500 maximum a worker can contribute to an FSA each year, according to Treasury officials.

Eliminating the Rush to Spend

The change should "eliminate the wasteful spending that takes place each year as employees rush to consume their remaining FSA dollars due to the use-it-or-lose-it rule," said WageWorks' Jackson. "Employers, employees and their families now have more control and flexibility in managing their out-of-pocket health care expenses."

The agencies' action was in response to the public's comments, which the Treasury and IRS solicited. "An overwhelming majority of feedback from individuals, employers and others requested that the use-or-lose rule for health FSAs be modified," according to a Treasury statement. "Comments pointed to the difficulty for employees of predicting future needs for medical expenditures, the need to make FSAs accessible to employees of all income levels and the desire to minimize incentives for unnecessary spending at the end of the year."