IRS MODIFICATION OF FSA “USE OR LOSE” RULE

American Benefits Council P4P ... “Preparing for PPACA” Webinar

Christine Keller
November 21, 2013
Notice 2013-71

- Allows optional adoption of $500 (or less) carryover for Health FSA (not DCAP)
  - Carryover does not reduce $2500 salary reduction amount in the following year
  - Must be uniformly available
  - In lieu of grace period
  - “Uniform Coverage” rule is not modified

- Significant departure from IRS’s historic position that “use or lose” is necessary to avoid prohibited deferral of compensation.
<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Increased participation of employees (FICA savings)</td>
<td>• Loss of forfeitures</td>
</tr>
<tr>
<td>• Ending wasteful end-of-year spending</td>
<td>• Some additional administration</td>
</tr>
<tr>
<td></td>
<td>• Requires cancellation of grace period</td>
</tr>
<tr>
<td></td>
<td>• Some HSA complications</td>
</tr>
</tbody>
</table>
Grace Period vs. Carryover

Grace Period
- Applies to entire Account Balance
  - Participants who planned for large expenditure during Grace Period won’t lose contributions

Carryover
- Duration not limited
- Reduces financial risk of loss for participants with favorable health experience and low claims
Amendment Timing

● Could be effective for 2013
  ● Must announce before end of plan year
  ● Must amend plan before end of plan year beginning in 2014
  ● If grace period, must amend plan before plan year-end to eliminate grace period
    ○ Address any non-Code legal constraints
HSA- Eligible Individual Status

- **General Rule**
  - Individuals with non-HDHP coverage are not HSA-eligible (i.e., not able to make monthly contribution)

- **Exception**
  - Does not apply to “permitted insurance,” including accident and critical illness, “permitted coverage,” including dental/vision and coverage for preventive care
  - Rev. Rul. 2004-45 addresses FSA/HRA and HSA interaction

- **Grace Period impacts HSA eligibility**
  - Code § 223 provides exception for those with zero balance on last day of plan year (e.g., 12/31), measured on cash basis
HSA- Eligible Individual Status

- Carryover to general purpose FSA would impact HSA eligibility
- Possible work-arounds:
  - Allow waiver of carryover
  - Preclude carryover for those who enroll in HSA
  - Convert carryover to limited purpose or post-deductible FSA
Administrative Issues

- Coordination with runout period
  - Carryover determined after any “run-out” period claims (Example 1)
  - Ordering rule: may want to reimburse current year claims from current year salary reductions first (Example 2)

- Carryover is indefinite (Example 4)
  - Unless terminate employment
  - Can employer end carryover if participant has no claims for more than one year?

- Could be capped at less than $500
  - But must be uniformly applied
Administrative Issues

- Required FSA participation in the next plan year
  - Can the employer require a minimum salary reduction election in the next plan year?
- Minimum carryover amount
  - Example – can only carryover amounts $10 and over
Questions

CKeller@Groom.com
(202)861-9371