



AMERICAN BENEFITS COUNCIL

April 24, 2012

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Re: Request for Transition Relief for Certain Plans Regarding Limitation on Salary Deferral Contributions to Health Flexible Spending Arrangements

Mr. Bostick and Mr. Iwry:

We write on behalf of the American Benefits Council (“Council”) to respectfully request that the Internal Revenue Service and the Department of the Treasury (collectively, the “Service”) provide transition relief for certain non-calendar year plans with respect to the limitation on health flexible spending arrangements (“health FSAs”) imposed by section 9005 of the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the “Affordable Care Act”).

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either sponsor directly or provide services to health and retirement plans that cover more than 100 million Americans.

Section 9005 of the Affordable Care Act provides that, effective for “taxable years” beginning after December 31, 2012, in order for a benefit to be treated as a qualified benefit under a health FSA for purposes of section 125 of the Internal Revenue Code of 1986, as amended (“Code”), “an employee may not elect for any taxable year to have

salary reduction contributions in excess of \$2,500 made to such arrangement,” adjusted for inflation in future years.

We urge the Service to issue transition relief that makes clear that health FSAs with non-calendar plan years will not be subject to the limitation on salary deferral contributions for plan years beginning before January 1, 2013. As discussed below, absent the requested relief, such non-calendar year plans could be subject to the limitation in advance of the statutory effective date of January 1, 2013 and as a result could be required to undertake costly and burdensome actions to the detriment of employees who participate in such plans.

TRANSITION RELIEF IS NEEDED FOR NON-CALENDAR YEAR HEALTH FSAS

For various organizational reasons, many employers do not administer their health FSAs on a calendar year basis. As a result, the statutory effective date of the limitation on salary deferral contributions does not clearly align with the plan offerings of these employers. This is because, were the IRS to apply the limitation on a calendar year basis, it would have the effect of causing health FSAs that operate on a non-calendar year basis to have to comply with the limitation earlier than the statutory effective date. Thus, in the absence of transition relief, an employer may be forced to limit salary deferral contributions *before* the limitation becomes effective, i.e., for the plan year beginning in 2012.

For example, consider a health FSA with a fiscal year beginning July 1, 2012. Employees must make salary deferral elections for such fiscal year no later than July 1, 2012, and such elections will remain effective through June 30, 2013 (i.e., after the effective date of the limitation). The employee elects to defer \$3,600 for the plan year beginning July 1, 2012. This translates to a salary reduction of \$300 per month from July 1, 2012 through June 30, 2013. If the employee then elects to contribute \$2,500 for the fiscal year commencing July 1, 2013 (i.e., the maximum contribution permitted for taxable years beginning after December 31, 2012), then he will run afoul of the \$2,500 annual limitation in 2013 if the limitation is construed as becoming effective for the January 1, 2013 calendar year, since he will have deferred \$300 for the first six months of 2013 and \$208.33 for the last six months of 2013, for a total of \$3,050 – a violation of the \$2,500 limit for 2013.¹

¹ We note that Proposed Treasury Regulation section 1.125-5 makes clear that deferrals to a health FSA must be made over uniform intervals throughout a year. The proposed regulations are less clear, however, as to whether equal amounts must be deferred at each interval. Most plans are structured to provide for equal deferrals over uniform intervals. This can result in a “yo-yo” effect for employees in non-calendar year plans who seek to maximize their annual health FSA election. For example (assuming the IRS applies the limitation on a calendar year basis), in order to comply with the limitation for the 2013 calendar year, the employee described in the text would only be able to contribute an additional \$700 (\$116.67 per month) for the remaining six months of 2013. This means that the employee would defer an

Congress clearly did not intend that the limitation on salary deferral contributions to health FSAs become effective *prior to* January 1, 2013. However, in the absence of overhauling the structure of their health FSAs, many employers may be forced to impose limits prior to such date. This would be unfair to employees who would otherwise be able to defer an additional amount leading up to 2013.

Additionally, it seems clear that, in imposing the salary deferral contribution limitation, Congress did not intend to require that all health FSAs be operated on a calendar year basis. In the absence of transition relief, this could very well be the unintended result. In some cases, a health FSA's 2012 fiscal year has already begun (e.g., a plan with a fiscal year beginning April 1, 2012). Where this is the case, employers do not have the option of imposing the \$2,500 limitation for the 2012 fiscal plan year, as elections for the plan year have already been made by employees.

The only other course of action available to the employer is to make the 2012 plan year a "short" plan year ending December 31, 2012, with the next "full" plan year beginning on January 1, 2013. In this case, the imposition of the limitation on other than a plan year basis essentially forces an employer to change its health FSA's plan year to a calendar year on a going-forward basis. This may be unacceptable to employers for any number of reasons, including that their other health benefits operate on non-calendar plan years.

It seems clear that Congress did not intend for the imposition of the salary deferral contribution limitation to cause employers to have to undertake a significant overhaul of the structure of their health FSAs, which may cause internal inconsistencies in connection with the operation of other health benefits offered by the employer, in order to merely comply with the limitation on salary deferral contributions to the health FSA.

FREQUENTLY ASKED QUESTION GUIDANCE

Our request is merely for transition relief, not an interpretation of the term "taxable year." After 2013, there will not be a compliance issue on a going-forward basis, given that no employee would be able to elect to contribute more than \$2,500 in any calendar year, regardless of whether the health FSA in which he or she participates is operated on a calendar year basis.

annualized amount of \$1,400, with the remaining \$700 being deferred in the first six months of 2014. In order to maximize deferrals for 2014 and later years, the employee would then have to again defer \$300 per month for the plan year beginning July 1, 2014 (an annualized amount of \$3,600), \$116.67 per month for the plan year beginning July 1, 2015 (an annualized amount of \$1,400), and so on. This issue can be resolved by providing the requested transition relief with respect to the 2012 plan year for non-calendar year plans.

We urge the Service to issue the requested transition relief as expeditiously as possible. We understand that this may preclude the relief from being issued pursuant to formal rulemaking processes; however, we strongly encourage the Service to at least issue relief in the form of Frequently Asked Questions (“FAQs”) in order to provide certainty to employers in interpreting the limitation as initially becoming effective with respect to the *plan year* commencing after December 31, 2012.

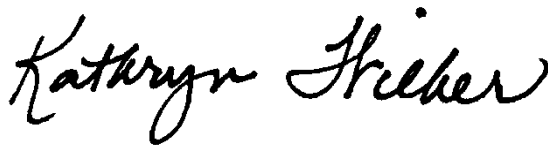
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We thank the Service for its consideration of our request for transition relief regarding the limitations on salary deferral contributions to health FSAs effective for taxable years beginning after December 31, 2012. If you have any questions or would like to discuss these comments further, please contact us at (202) 289-6700.

Sincerely,



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