

New Alternative for Health FSAs to Avoid Year-End Race to the Doctor to Use Funds

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The “Use It or Lose It” health flexible spending account (“HFSA”) rule has long provided an incentive for employees to purchase eyeglasses in multiple colors at year end to avoid losing the funds in their accounts. Well, the IRS has now provided an alternative to this year-end rush to use HFSA funds and it can apply as early as 2013, if your HFSA record keeper can handle the rule change and provided your HFSA does not use the “grace period rule” (permitting use of funds in the HFSA with claims incurred in up to the 2½ months following the end of the plan year which is different than a run-out period which permits claims incurred in the prior plan year to be submitted after year end). The new rule permits the carryover of up to \$500 of unused HFSA funds into the subsequent plan year to be used anytime in that plan year and not just within the first 2½ months as required under the grace period rule. This is a \$500 carryover and it is not \$500 per year that accumulates to a larger and larger carryover. The \$500 carryover does not reduce the \$2,500 salary reduction limit, which will eventually be indexed. (There was no increase in the limit for 2014).

In order to be able to use the \$500 carryover with a HFSA, the plan must be amended by the end of the plan year from which the funds will first be carried forward; however, if you and your record keeper are going to implement this rule for a plan year beginning in 2013, you have until the end of your plan’s 2014 plan year to make the amendment to the plan to provide for the carryover. Employers should verify with the HFSA plan’s record keeper when they will be able to administer the new provision in compliance with the new requirements. Employers must also communicate the new carryover rule to the participants so that employees have an opportunity to use it. The new carryover rule must be available on a nondiscriminatory basis.

Employers offering multiple benefit options which include a high deductible health plan with a health savings account issue will need to carefully communicate with employees regarding the impact of carrying over funds in a general purpose HFSA into a year in which they elect the high deductible health plan coverage because this general purpose HFSA coverage will impact the deductible nature of their health savings account contributions.

If your HFSA currently uses the grace period rule and you want to change to the carryover rule, you will need to amend your plan to eliminate the grace period rule because the guidance requires that you cannot have both the grace period rule and the carryover rule in effect in the same plan year.

Health Reform’s Interaction with Cafeteria or Flexible Benefit Plan Election Changes

Many questions are arising as the result of the implementation of the insurance marketplaces or exchanges and the issues related to the operation of the federal marketplace and how that impacts employee elections under the employer’s cafeteria plan or flexible benefit plan for coverage. Cafeteria plan benefit elections occur during open enrollment and then are set for the next plan year (typically the calendar year). The guidance issued yesterday addressed the interaction of health reform and cafeteria plan elections only for fiscal year cafeteria plans (non-calendar year plans). It did not address the issue of what an employer is to do when their open enrollment period for 2014 has closed and the employee now wants to drop the coverage they elected in open enrollment because they were just able to get coverage on the insurance marketplace.

If you have a fiscal year cafeteria plan, the guidance did help you with the interaction of your cafeteria plan with health reform. The guidance revised a prior transition rule under health reform to permit all employers to use it regardless of whether they were part of a group of companies subject to the health reform employer shared responsibility penalty also known as the pay or play penalty (i.e., it applies to employers with fewer than 50 full time employees). The fiscal year cafeteria plans may adopt a plan provision that permits an employee who made an election of health coverage or no health coverage for a non-calendar year plan to prospectively revoke or change their elections with respect to the health plan coverage once during the plan year. This can be a change to add or delete health coverage prospectively once during the year without needing to have one of the status change events listed in the IRS regulations. Employers may elect to be more restrictive than offering the above described election change, but cannot provide the employees with more or greater options.

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