

TREASURY MODIFIES “USE-OR-LOSE” RULE FOR HEALTH FLEXIBLE SPENDING ARRANGEMENTS

The U.S. Department of the Treasury and the IRS today issued a notice modifying the longstanding “use-or-lose” rule for health flexible spending arrangements (FSAs). For the first time, at the plan sponsor’s option, employees participating in health FSAs will be allowed to carry over – instead of forfeiting – up to \$500 of unused amounts remaining at year-end. For a copy of the modification notice, click [here](#).

What’s a health FSA?

Health FSAs are benefit plans that employers can sponsor to allow their employees to be reimbursed on a tax-favored basis for certain medical expenses that are not covered by the employer’s major medical plan. An estimated 14 million families participate in health FSAs. Health FSAs may be offered in conjunction with other employer-provided benefits as part of a cafeteria plan. They are commonly funded by employees through voluntary salary reduction contributions, and employers may also contribute. Contributions to an FSA are not includible in the employee’s income, and reimbursements from an FSA that are used to pay qualified medical expenses are not taxed.

How do health FSAs work?

Generally, employees decide before the beginning of the plan year how much money they want to contribute to the FSA. Throughout the year, they can draw from this account for qualified medical expenses that are not covered by their employer’s main health plan. This can include copays, deductibles, and various medical services and products – from dental and vision care to eyeglasses and hearing aids. For the past 30 years, health FSAs have been subject to a “use-or-lose” rule, meaning that any funds left unused at the end of the year are forfeited.

What’s changed and how does this help consumers?

Today’s notice makes health FSAs more consumer friendly by relaxing the use-or-lose rule. This will enable employers, for the first time, to permit employees to use up to \$500 of unused health FSA amounts in the next year, instead of forfeiting the unused amounts. Notably, most forfeitures are less than \$500. Individuals can now participate in a health FSA without the risk of losing all of their unused contributions. This also cuts back on wasteful year-end FSA healthcare spending by limiting the risk of forfeiture, and in turn, reducing the incentive to spend down as year-end approaches in order to avoid losing unused funds. Some plan sponsors may be eligible to take advantage of the option to adopt a carryover provision as early as plan year 2013.

How do I participate?

An employer that sponsors a health FSA can choose to allow its employees to carry over unused amounts of up to \$500 to use to reimburse qualified medical expenses incurred during the following year. Plan sponsors now have the choice of either allowing employees a carryover of up to \$500 or allowing them a grace period of up to two and a half months (though employers are not required to allow either). A health FSA cannot, however, have both a carryover and a grace period.