

# Compliance Alert

## IRS Provides Guidance on \$2500 Health FSA Limit

Release Date: June 1, 2012

The IRS has released Notice 2012-40 which provides welcome guidance to employers regarding the \$2500 limit on Health FSA (HFSA) pre-tax contributions imposed by the Affordable Care Act (ACA). Most significantly, Notice 2012-40 clarifies that the \$2500 limit only applies to HFSA plan years beginning on or after January 1, 2013.

### Background

Beginning January 1, 2013, the ACA imposes a \$2500 maximum on the amount of employee pre-tax salary reduction contributions which can be made to an HFSA for any **%taxable year+**. The \$2500 limit is indexed in future years.

For HFSA plans with plan years beginning January 1<sup>st</sup>, it was clear that employers would need to restrict employee contributions beginning with the January 1, 2013 plan year. However, there was confusion regarding how the rule would apply to plans with non-calendar year plan years. Notice 2012-40 clears up this confusion, and addresses additional HFSA related issues.

### Details of Guidance

Primary guidance contained in Notice 2012-40 includes:

- The \$2500 limit applies to plan years beginning on or after January 1, 2013. For example, the limit will apply to an HFSA with a July 1<sup>st</sup> plan year beginning with the July 1, 2013 plan year.
- The term **%taxable year+** refers to the HFSA plan year of the cafeteria plan, not the calendar year.
- In the case of a plan providing a grace period, unused salary reduction contributions that are carried over into the grace period will not count against the \$2500 limit for the subsequent year.

Other guidance was also included in the notice which addresses some of the questions employers have regarding the limit.

- The \$2500 limit applies on an employee-by-employee basis. Thus, \$2500 is the maximum salary reduction contribution each employee may make for a plan year, regardless of the number of other individuals (e.g. a spouse or dependent) whose expenses are reimbursable under the plan.
- If each of two spouses is eligible to elect an HFSA, each spouse may elect to make salary reduction contributions of up to \$2500 to his or her HFSA, even if both participate in the same HFSA sponsored by the same employer.

### Plan Must be Amended

A cafeteria plan offering an HFSA must be amended to reflect the \$2500 limit. Under Section 125 rules, cafeteria plan amendments normally must be made only prospectively. However, in this case the IRS will allow the amendment to be made retroactively, as long as the plan is amended by December 31, 2014.

### Request for Comments on Possible Modification of Use-Or-Lose Rule for Health FSAs

Under current rules any unused contributions at the end of the plan year (or grace period if applicable) are forfeited by the participant. This is often referred to as the **%use-or-lose+** rule. In light of the \$2500 limit, the IRS is considering whether to amend the use-or-lose rule. The IRS is taking comments through August 17, 2012 on potential changes to this rule.

*While every effort has been taken in compiling this information to ensure that its contents are totally accurate, neither the publisher nor the author can accept liability for any inaccuracies or changed circumstances of any information herein or for the consequences of any reliance placed upon it. This publication is distributed on the understanding that the publisher is not engaged in rendering legal, accounting or other professional advice or services. Readers should always seek professional advice before entering into any commitments.*