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November 8, 2013

Modified "Use-It-or-Lose-It" Rule for Health FSAs

The Internal Revenue Service recently issued Notice 2013-71 ("Notice") modifying the "use-it-or-lose-it" rule applicable to health flexible spending accounts ("FSAs"). The modified rule now permits (but does not require) cafeteria plans to allow up to $500 of unused health FSA contributions to be carried over into the next year. The carryover option does not affect the annual limit on contributions to health FSAs ($2,500) and can be offered as an alternative to a grace period.

Background. The "use-it-or-lose-it" rule for health FSAs originally provided that any amounts left in a participant's health FSA at the end of a year must be forfeited as of the last day of that year, and could not be carried over or used in the next year. This rule was modified in 2005 to allow for a grace period during which partici-pants could use amounts remaining in their health FSA to pay expenses incurred up to 2 months and 15 days after the end of the year (*i.e.,* by March 15 of the next year for calendar year plans).

Modified Rule. The Notice further modifies the use-it-or-lose-it rule such that plan sponsors may (but are not required to) allow participants to carryover up to $500 remaining in the participants' health FSAs at the end of each year. Note that a plan's carryover provision does not affect a participant's ability to make maximum contributions – that is, a participant can still elect to contribute the maximum amount for a year even if the participant also carried over amounts from a previous year.

The Notice specifies that a plan may have either a grace period or a carryover provision, but not both. A plan can also limit the carryover to amounts less than $500.

Plan Amendments. Plan sponsors that wish to implement a carryover provision for their health FSAs must amend their cafeteria plans to adopt such a provision before the last day of the year in which the provision takes effect. However, if plan sponsors wish to implement the carryover provision for plan years beginning in 2013, cafeteria plans can be amended at any time on or before the last day of the plan year that begins in 2014.

Action Items. If a plan sponsor would like to implement a carryover provision for 2013 in a plan that does not currently offer a grace period, the plan sponsor should inform plan participants immediately of the change. Furthermore, if a plan currently has a grace period, the plan sponsor may want to wait to implement the carryover provision until 2014 so that plan participants who relied on the grace period for the 2013 plan year have sufficient notice of the change.

Contact Information. For more information from Mazursky Constantine, please contact Amy Heppner (404.888.8825), Kelly Meyers (404.888.8838)or Carl Lammers (404.888.8872

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