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HEALTH CARE REFORM New Health Flexible Spending Account Limit Applies on a Plan-Year Basis

The IRS has confirmed that the \$2,500 annual limit on salary reduction contributions to health flexible spending accounts ("FSAs") applies on a plan-year basis (rather than a calendar-year basis) and is **effective for plan years beginning on or after January 1, 2013**.

Background. The Health Care Reform Act limits the amount an employee may contribute to a health FSA to \$2,500 (as indexed for inflation) for taxable years beginning on or after January 1, 2013. Originally, it was not clear how this limit would apply to non-calendar-year health FSAs - that is, whether the limit would apply on a calendar-year basis or a plan-year basis.

New Guidance. Recent IRS guidance provides that the \$2,500 annual limit applies on a plan-year basis and is effective for plan years beginning on or after January 1, 2013.

For example, assume a health FSA has May 1st through April 30th plan year. Under the IRS guidance, the \$2,500 contribution limit would not apply until the 2013 plan year, which begins May 1, 2013. Participants can continue to contribute the amounts they have elected for 2012 during remaining four months of the 2012 plan year (January to April 2013) even if these amounts exceed \$2,500.

Additional highlights of the guidance include:

- The annual limit applies only to salary reduction contributions to a health FSA and does not apply to non-elective employer contributions.
- Unused salary reduction contributions for a plan year made available to an employee during a plan's grace period (which may be up to 2 months and 15 days after the end of the plan year) do not count against the employee's annual limit for the following plan year.
- Plan sponsors have until December 31, 2014, to amend their cafeteria plan documents to reflect the new annual limit.

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