November 7th, 2013

NEW RULES FOR CAFETERIA PLANS

New Carry-Over Option

On October 31, 2013, the IRS published Notice 2013-71 that modified the long-standing “use-it or lose it” rule in a Section 125 health Flexible Spending Arrangement (FSA). For the first time, at the option of the employer, employees participating in a health FSA may carry over - instead of forfeiting - up to $500 of unused amounts remaining in a health FSA after the end of the run-out period. Employees may use the carry-over amount for qualifying expenses incurred in the following plan year. The carry-over amount cannot be cashed out or used for any other taxable or nontaxable benefits – it can only be used for expenses that qualify under a health FSA. The new carry-over amount cannot be used for DCAP arrangements.

The carry-over option does not affect the maximum salary reduction amount of $2,500 currently allowed (indexed for years after 2014). If the employer decides to offer the carry-over option, an employee may make a $2,500 salary reduction election, in addition to carrying over unused health FSA funds up to $500.

The carry-over option also does not affect the claims run-out period for a health FSA (typically 30, 60, or 90 days). Currently, unused health FSA funds may be used to pay qualifying medical expenses incurred in the prior plan year if the participating employee submits a claim during the subsequent run out period.

The carry-over option is an alternative to the optional grace period allowed under current law. Employers can decide to allow: 1) the carry-over option; 2) the grace period; or 3) neither. The carry over option and the grace period cannot be offered together. Employers can implement the new carry-over option for any plan year beginning on or after January 1, 2013, if the employer amends its cafeteria plan on or before the end of the plan year for which unused health FSA amounts may be carried over.

If you are interested in adding this new carry-over option, you must decide whether to adopt this option for your current plan year or for any future plan year. If you currently permit a grace period and want to offer the carry-over option, you must amend your plan to remove the grace period and add the carry-over option. EBMS recommends that plans finalize these amendments by the end of the plan year. EBMS also suggests that plans give written notice to employees of the plan’s intent to offer the carry-over option on or before the start of the plan’s upcoming annual enrollment period.

One-Time Election Change Opportunity for Non-Calendar Year Plans

In Notice 2013-71, the agencies clarified that non-calendar year plans may offer an optional mid-year election change for health coverage (not health FSA or DCAP) without a change in status. This optional mid-year
election change would accommodate employees who want to purchase coverage through a State Insurance Exchange and drop their previously elected employer-sponsored coverage.

Employers offering a non-calendar year plan can allow plan members an optional one-time opportunity to make a mid-year election change without a qualified change in status:

- To prospectively revoke or change their elections for health plan coverage during the 2013 plan year; and/or
- To make a prospective salary reduction election for health coverage if the employee failed to elect health coverage at the beginning of the 2013 plan year. *Note that the underlying health plan must also permit enrollment at times other than special enrollment or annual enrollment.

Changes to Non-Excepted Benefit Health FSAs

On September 13, 2013, the IRS published Notice 2013-54 that clarified that health FSA’s that are not considered “excepted benefits” are subject to market reforms, including the preventive care requirements and prohibition against annual dollar limits.

To be considered an excepted benefit, a health FSA must limit the maximum benefit payable to a participant to two times the employee’s salary reduction election or if greater, the salary reduction election plus $500.

If the employer offers the health FSA through a cafeteria plan and permits funding only by salary reduction contributions from the employee and any optional carry-over amount as described above, the health FSA would be an excepted benefit. No market reforms would apply.

If the employer offers employer flex credits or some other method of employer funding in addition to salary reduction contributions from the employee and any optional carry-over amount as described above, the health FSA may not be an excepted benefit. EBMS recommends that employers discontinue providing employer contributions to the employer’s health FSA to avoid application of the market reforms.

For more information, contact your Strategic Account Manager, EBMS’ Consumer Driven Health Plan Account Manager, or a member of the EBMS Legal Department.