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Health Flexible Spending Accounts (FSA) Permitted to Allow $500 Annual Carry Over: 2014 Benefit Plan Limits Issued

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Health FSAs

The longstanding use-it-or-lose-it rule applicable to **health flexible spending accounts** (FSAs) prohibited participants from carrying over a balance from one plan year to the next. If the participant failed to incur eligible expenses equal to his or her FSA account by the end of the plan year, or any applicable optional grace period (generally 2 months and 15 days after the end of the plan year)[1], the money would be lost. However, on October 31, 2013, the Internal Revenue Service (IRS) issued Notice 2013-71 providing that a cafeteria plan may allow up to $500 of a participant's balance at the end of the plan year to be carried over into the next plan year and used for eligible medical expenses incurred during that next plan year.

The change announced in Notice 2013-71 is purely optional. Cafeteria plans are not required to permit this carryover (and similarly are not required to adopt a grace period). This change also does not affect the maximum amount that may be contributed by a participant to an FSA for a plan year, currently $2,500. However, the carryover amount does not reduce the participant's maximum FSA contribution for the next plan year. Thus, a participant who carries over $500 to the next plan year and who also contributes $2,500 to his or her FSA for that plan year may be able to receive reimbursements from his or her FSA for up to $3,000 of eligible medical expense during that plan year.

In order for a participant to be able to carry over unused amounts, the plan must be amended to permit such a carryover. Additionally, a plan may not offer a participant the option to carry over an unused amount and allow a grace period.

Therefore, if the plan currently offers a grace period (which, as noted above, may allow participants to incur services for up to an extra 2 months and 15 days following the end of the plan year to utilize unused amounts), this plan provision must be removed before the plan may permit carryovers. Consequently, plan sponsors who currently offer a grace period will need to decide whether the grace period or the carryover option is a more desirable plan design. Again, plans are not required to adopt either this carryover option or a grace period option.

Any amendment allowing a participant to carry over up to $500 of unused amounts must be adopted on or before the last day of the plan year from which unused amounts are to be carried over. For example, if the carryover option is being adopted for 2014 for a calendar year plan, the plan will need to be formally amended by December 31, 2014 to reflect this change. Please note, however, that an amendment to permit carryover of amounts from a plan year beginning in 2013 may be adopted at any time before the last day of the plan year that begins in 2014.

2014 Benefit Plan Limits

For 2014, cost-of-living adjustments have increased some key benefit plan numbers, as follows:

	2014	**2013**
Annual Compensation Limit	$260,000	$255,000
Defined Contribution Section 415 Limit	$52,000	$51,000
Defined Benefit Section 415 Limit	$210,000	$205,000
Key Employee	$170,000	$165,000
Taxable Wage Base	$117,000	$113,700

The below numbers are the same in 2014 as in 2013:

	2014	**2013**
Elective Deferral (401(k)/403(b)) Limit	$17,500	$17,500
Catch-Up Contribution Limit	$5,500	$5,500

[1] Grace periods have been permitted since 2005 pursuant to IRS Notice 2005-42. A grace period is distinct from the so called “run out period” during which a participant may submit a claim for reimbursement for eligible medical expenses incurred during the plan year (plus any optional grace period).

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