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YOUR SOLUTION FOR HUMAN CAPITAL MANAGEMENT

IRS Announces New Health FSA Carryover and 2014 Benefit Plan Limits

The Department of Treasury (DOT) and Internal Revenue Service (IRS) made two important announcements for employers to be aware of.

1. New Carryover Provision; the DOT announced on October 31, 2013 a major policy change that will impact Flexible Spending Accounts (FSAs). The most significant of the changes made by the DOT was the modification of the "Use It or Lose It" provision for health FSA plans to now allow a carryover of FSA funds (up to $500) from one Plan Year to the next.
2. 2014 Pre-tax Limits Released; the Internal Revenue Service has announced various adjustments to employee benefit plan and individual retirement account (IRA) dollar limits and thresholds for 2014, principally as a result of the increase in the applicable cost-of-living indexes. The following limits and thresholds are effective for plan years and limitation years beginning in 2014.

The New Carryover Provision

Under the new rule, an employer, at its option, may permit a participant to carry-over to the next plan year up to $500 in unused amounts from a health care FSA. This carryover may be used to pay or reimburse medical expenses under a health care FSA incurred during the entire plan year to which it is carried over.

Key guidelines under this new rule:

- The carryover does not count against or affect the maximum payroll reduction limit for the plan year ($2,500 for 2014).
- An employer can set the amount of funds it will permit to be carried over from year to year, but the maximum allowed to be carried over to any plan year is $500.
- The amount of the permitted carryover must be the same for all plan participants.
- A plan that adopts the carryover provision is not permitted to also provide the FSA grace period, the plan can only provide one or the other.
- The use of the carryover option does not affect the plan's ability to provide for the payment of expenses incurred in one plan year during a permitted "run-out" period at the beginning of the following year. *"Run-out" period is a date that marks the cut off for filing claims for the previous year.*
- A plan is permitted to treat reimbursements of all claims that are incurred in the current plan year as reimbursed first from unused amounts credited for the current plan year and, only after exhausting these amounts, as then reimbursed from unused amounts carried over from the previous year.
- Any carryover amount used to pay for eligible medical expenses in the current plan year will reduce the amounts available to pay claims during the run-out period from the prior plan year.

2014 Pre-tax Limits Released

Each year the IRS announces the new limits for various aspects of employee benefits plans and individual retirement account (IRA) dollar limits and thresholds for 2014. The following limits are effective for plan years and limitation years beginning in 2014:

- Highly Compensated Salary 2014: $115,000 (unchanged from 2013)
- Transportation Benefit:
  - Parking 2014: $250/month (increased from 2013: $245/month)
  - Transit 2014: $130/month (decreased from 2013: $245/month)
- Flexible Spending Accounts:
  - Medical Out-of-Pocket Expenses 2014: $2,500 (unchanged from 2013)
  - Dependent Care Expenses 2014: $5,000 (unchanged from 2013)
- Qualified Long-Term Care Insurance Premiums:
  - 40 or younger—2014: $370 (2013: $360)
  - 41-50—2014: $700 (2013: $680)
  - 51-60—2014: $1,400 (2013: $1,360)
  - 61-70—2014: $3,720 (2013: $3,640)
  - 71 and older—2014: $4,660 (2013: $4,550)
- Social Security Taxable Wage Base
  - 2014: $117,000 (Increased from 2013: $113,700)
- Health Savings Accounts (HSA) Limits:
  - HSA Annual Contribution Levels
    - Individual—2014: $3,300 (2013: $3,250)
    - Family—2014: $6,550 (2013: $6,450)
    - Catch Up—2014: $1,000 (unchanged from 2013)
  - Maximum Out-of-Pocket for HSA High Deductible Health Plan (HDHP)
    - Individual—2014: $6,350 (Increased from 2013: $6,250)
    - Family—2014: $12,700 (Increased from 2013: $12,500)
  - Minimum Deductible for HSA HDHP
    - Individual—2014: $1,250 (unchanged from 2013)
    - Family—2014: $2,500 (unchanged from 2013)

For the IRS full list of limit changes please click here.

Key Points and Next Steps for Employers

Determine whether you want to permit a carryover of unused funds in your health FSA (keeping in mind that you will need to eliminate any grace period that you might have in place, since you can't have both). Employers have the following options to choose from:

Option 1: End current Plan Year unchanged. Add the Carryover to the new Plan Year. In this option, Participants may continue to incur eligible expenses and submit requests for reimbursement during the Grace Period (if already elected for the current Plan Year) and may submit requests for reimbursement during the subsequent Run-out Period for eligible expenses incurred in the previous Plan Year. *Employers that want to implement the new carryover option must amend its cafeteria plan on or before the last day of the plan year.*

Option 2: Elect Carryover for the current Plan Year. Employers may elect the Carryover to be effective with this current Plan Year. Those who elect the Carryover may not elect the Grace Period for their health benefit; it's one or the other. *Employers that want to implement the new carryover option must amend its cafeteria plan on or before the last day of the plan year.*

Option 3: Make no changes to current or future FSA plan. Consider whether your employees would benefit from adopting the carryover rule or the grace period rule. The carryover rule is limited to $500 but permits the $500 to be used to pay for eligible expenses during the entire year into which it was carried over. In contrast, the grace period rule permits the entire amount of unused dollars in a health care FSA to be used but only to pay expenses incurred during the first 2 1/2 months of the next year. *Nothing requires an employer to have a grace period or a carryover feature, both are option. A health FSA cannot, however, have both a carryover and a grace period.*

- **Employers must notify participants of implementing the new carry-over rule;** the employer must notify participants of the new rule and the employer's choice to adopt this rule. *HR Knowledge believes that adopting the carry-over rule will most likely increase enrollment in FSA programs.* It is important to communicate any changes to participants so they can properly plan their FSA withholding levels and usage of the funds.
- **Note the 2014 IRS Benefit and IRA limits;** Employers should update their plan documents with the new IRS limits. *Please notify HR Knowledge of all plan changes to we may capture these changes on your benefits-at-a-glance and other important documents by emailing* benefits@hrknowledge.com.
- **If HR Knowledge is the broker for your Health FSA please contact us to;**
    1. Determine when this change will take effect – 2013, 2014, or later
    2. Develop and distribute appropriate notices to your employees
    3. Prepare the necessary amendments to your health FSA plan

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