Health FSA Carryovers

A health flexible spending account (FSA) is an employer-sponsored account that employees can use to pay for or reimburse their qualifying medical expenses on a tax-free basis, up to the amount contributed for the plan year. Health FSAs are subject to a “use-or-lose” rule that generally requires any unused funds at the end of the plan year (plus any applicable grace period) to be forfeited.

As an exception to the use-or-lose rule, employers may allow participants to carry over up to $500 in unused funds into the next year. Any unused amount in excess of $500 (or a lower amount specified in the plan) remaining at the end of the plan’s run-out period for the plan year must be forfeited.

The carryover of up to $500 may be used to pay or reimburse medical expenses under the health FSA incurred during the entire plan year to which it is carried over. Also, the carryover amount does not count toward the Affordable Care Act’s (ACA) limit on employees’ salary reduction contributions to a health FSA.

LINKS AND RESOURCES

- IRS’ [Office of Chief Counsel Memorandum](#) regarding impact of health FSA carryovers on HSA eligibility
- [Notice 2013-71](#), IRS guidance permitting health FSA carryovers
- [FAQs](#) from the DOL regarding health FSA carryovers and excepted benefits
HEALTH FSA RULES

The “use-or-lose” rule generally prohibits any contribution or benefit under a health FSA from being used in a later plan year or period of coverage. Employees must generally use health FSA funds by the end of the plan year or the funds will be lost. The IRS allows employers to offer an extended deadline, or grace period, of two and a half months after the end of a plan year to use remaining health FSA funds.

In addition, the ACA imposes a dollar limit on employees’ annual pre-tax salary reduction contributions to a health FSA offered under a cafeteria plan. The ACA set this limit at $2,500, effective for plan years beginning on or after Jan. 1, 2013 (indexed for cost-of-living adjustments in later years). An employer may impose its own dollar limit on employees’ salary reduction contributions to a health FSA, as long as the employer’s limit does not exceed the ACA’s maximum limit in effect for the plan year.

CARRYOVERS

An employer, at its option, may amend its Section 125 cafeteria plan document to allow up to $500 of unused funds remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year. For this purpose, the remaining unused amount as of the end of the plan year is the amount unused after medical expenses have been reimbursed at the end of the plan’s run-out period for the plan year.

The IRS has provided the following rules for health FSA carryovers:

 ✓ A health FSA may specify a lower amount as the maximum (and has the option of not permitting any carryover at all);

 ✓ A health FSA may permit carryovers only if it does not also incorporate the grace period rule;

 ✓ The carryover of up to $500 may be used to pay or reimburse medical expenses under the health FSA incurred during the entire plan year to which it is carried over;

 ✓ A health FSA may limit the ability to carry over unused amounts to a maximum period (for example, a health FSA can limit the ability to carry over unused amounts to one year); and

 ✓ A cafeteria plan is not permitted to allow unused amounts relating to a health FSA to be cashed out or converted to any other taxable or nontaxable benefit.

In addition, if an employer amends its plan to adopt a carryover, the same carry-over limit must apply to all plan participants. However, an employer may limit the availability of health FSA carryovers to individuals who have elected to participate in the health FSA in the next year, even if the ability to participate in the health FSA requires employees to make a minimum salary reduction election.
In Notice 2015-87, the IRS provided the following example to help explain how this eligibility rule works:

**Example:** Employer sponsors a cafeteria plan offering a health FSA that permits up to $500 of unused health FSA amounts to be carried over to the next year, but only if the employee participates in the health FSA during that next year. To participate in the health FSA, an employee must contribute a minimum of $60 ($5 per calendar month). As of Dec. 31, 2018, Employee A and Employee B each have $25 remaining in their health FSA. Employee A elects to participate in the health FSA for 2019, making a $600 salary reduction election. Employee B elects not to participate in the health FSA for 2019. Employee A has $25 carried over to the health FSA for 2019, resulting in $625 available in the health FSA. Employee B forfeits the $25 as of Dec. 31, 2018 and has no funds available in the health FSA thereafter.

**Carry-over Amount**

With respect to a participant, the amount that may be carried over to the following plan year is equal to the lesser of:

- Any unused amounts from the immediately preceding plan year; or
- $500 (or a lower amount specified in the plan).

Any unused amount in excess of $500 (or a lower amount specified in the plan) remaining at the end of the run-out period for the plan year will be forfeited. Any unused amount remaining in an employee’s health FSA as of termination of employment will also be forfeited (unless the employee elects COBRA coverage with respect to the health FSA).

**Effect on the ACA Dollar Limit and Grace Period**

This carry-over rule does not affect the ACA’s dollar limit on salary reduction contributions. This means the plan may permit the individual to elect up to $2,500 (as adjusted for inflation) in salary reductions in addition to the $500 that may be carried over.

According to the IRS, this carry-over option provides an alternative to the current grace period rule and administrative relief similar to that rule. A plan adopting this carry-over provision may not also provide a grace period with respect to health FSAs. Also, for any plan year, the plan may not:

- Allow an individual to reduce his or her salary for qualified health FSA benefits more than the ACA’s indexed salary reduction limit; or
- Reimburse claims incurred during the plan year that exceed the ACA’s salary reduction limit (and any non-elective employer flex credits) plus the carry-over amount of up to $500.
**The Uniform Coverage Rule**

The uniform coverage rule continues to apply for plans adopting the $500 carryover. This rule requires the maximum amount of reimbursement from the health FSA to be available for claims incurred at all times during the period of coverage.

**Administration**

For ease of administration, a cafeteria plan is permitted to treat reimbursements of all claims for expenses that are incurred in the current plan year as reimbursed first from unused amounts for the current plan year, and, only after exhausting these current plan year amounts, as then reimbursed from unused carry-over amounts from the preceding plan year. Any carry-over amounts that are used to reimburse a current year expense:

- Reduce amounts available to pay prior plan year expenses during the run-out period;
- Must be counted against the permitted carryover of up to $500; and
- Cannot exceed the permitted carryover.

**WRITTEN CAFETERIA PLAN AMENDMENT REQUIRED**

To allow health FSA carryovers, a cafeteria plan offering a health FSA must be amended to include the carry-over provision. The amendment must be adopted on or before the last day of the plan year from which amounts may be carried over, and may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the rules in the notice and informs participants of the carry-over provision.

If a plan has provided for a grace period and is being amended to add a carry-over provision, the plan must also be amended to eliminate the grace period provision by no later than the end of the plan year from which amounts may be carried over. The ability to eliminate a grace period provision previously adopted for the plan year in which the amendment is adopted may be subject to non-Code legal constraints.

**CARRYOVERS AND HSA ELIGIBILITY**

The IRS released an [Office of Chief Counsel Memorandum](#) to provide information on how health FSA carryovers affect eligibility for health savings accounts (HSAs). Although the IRS memorandum is not official guidance, it helps clarify the IRS’ position on health FSA carryovers and HSA eligibility.

**Carryovers to General Purpose Health FSAs**

The IRS’ Office of Chief Counsel Memorandum provides that an individual who has coverage under a general purpose health FSA solely as a result of a carryover of unused amounts from the prior year is not eligible for HSA contributions.
This rule applies regardless of the amount available from the health FSA for any month during the plan year. Thus, the individual’s ineligibility for HSA contributions continues for the entire health FSA plan year, even for months in the plan year after the health FSA no longer has any amounts available to pay or reimburse medical expenses.

A cafeteria plan may provide that if an individual participates in a general purpose health FSA that provides for a carryover of unused amounts, the individual may elect prior to the beginning of the following year to decline or waive the carryover for the following year. In that case, the individual who declines or waives the carryover under the terms of the cafeteria plan may contribute to an HSA during the following year (assuming he or she meets the other tax rules for HSA eligibility).

**Carryovers to HSA-compatible Health FSAs**

An individual who participates in a general purpose health FSA and elects for the following year to participate in an HSA-compatible health FSA may elect to have any unused amounts from the general purpose health FSA carried over to the HSA-compatible health FSA (that is, a limited purpose health FSA or a post-deductible health FSA). This individual is eligible for HSA contributions during the following year (assuming he or she meets the other tax rules for HSA eligibility).

There is no requirement that the unused amounts in the general purpose health FSA only be carried over to a general purpose health FSA. However, the carry-over amounts may not be carried over to a non-health FSA or another type of cafeteria plan benefit.

A cafeteria plan that offers both a general purpose health FSA and an HSA-compatible health FSA may automatically treat an individual who elects coverage in an HDHP for the following year as being enrolled in the HSA-compatible health FSA and carry over any unused amounts from a general purpose health FSA to the HSA-compatible health FSA for the following year.

**Administration during Run-out Period**

If an individual elects to carry over unused amounts from a general purpose health FSA to an HSA-compatible health FSA, the uniform coverage rules may be applied during the run-out period of the general purpose health FSA, as follows:

- The unused health FSA amounts may be used to reimburse any allowed medical expenses incurred prior to the end of the general purpose health FSA plan year.
- Any claims covered by the HSA-compatible health FSA must be timely reimbursed up to the amount elected for the HSA-compatible health FSA plan year.
- Any claims in excess of the elected amount may be reimbursed after the run-out period when the amount of any carryover is determined.
APPLICATION TO EXCEPTED BENEFITS

Excepted benefits provided under a group health plan or health insurance coverage generally are exempt from HIPAA and the ACA’s market reform requirements. Effective for 2014 plan years, health FSAs must generally qualify as excepted benefits to satisfy the ACA’s market reforms. Health FSAs generally constitute excepted benefits if:

- The employer also makes available group health plan coverage that is not limited to excepted benefits for the year to the class of participants by reason of their employment; and
- The arrangement is structured so that the maximum benefit payable to any employee participant in the class cannot exceed:
  - Two times the employee’s salary reduction election for the arrangement for the year; or
  - If greater, $500 plus the amount of the participant’s salary reduction election.

An FAQ issued by the Department of Labor (DOL) clarifies that unused carry-over amounts remaining at the end of a plan year in a health FSA that satisfies the modified "use-or-lose" rule should not be taken into account when determining if the health FSA satisfies the “maximum benefit payable limit” prong under the excepted benefits regulations.