

Health FSAs and the \$500 Carryover Option



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Recently, the IRS issued an Information Letter confirming the carryover rules for Health Flexible Spending Arrangements, or Health FSAs. The Information Letter is available at: <https://www.irs.gov/pub/irs-wd/18-0012.pdf>.

As a reminder, a Health FSA is an employer-owned account that employees can contribute to on a pre-tax basis in order to pay for eligible healthcare expenses. It is an employee benefit that may be offered under a Section 125 cafeteria plan. Employee contributions to a Health FSA are subject to an annual cap, which for 2018 is \$2,650. Unused funds are forfeited to the employer at the end of each calendar year, except that an employer has the option to offer employees one of the following in its Section 125 plan documents:

- A grace period of 2.5 months (extending the deadline to use the FSA funds until March 15 of the following year); or
- A carryover of the unused FSA balance, up to \$500, to be used in the following year.

The IRS's Information Letter pertains to the second of these options. The IRS issued the letter in response to a request that "the [carryover] rules be changed to allow savings to be accumulated in these accounts over several years." The IRS responds that "Health FSAs can provide for the carryover of unused amounts on a limited basis." The IRS notes that, "[a]t its option, an employer can include a provision in a health FSA that allows amounts unused at the end of the plan year to be carried over to the next year up to \$500." In the letter, the IRS also distinguishes Health FSAs from Health Savings Accounts (HSAs) and Health Reimbursement Arrangements (HRAs), which do permit funds to be accumulated into later years to pay for certain medical expenses.

Employers looking to provide employees some relief from automatic forfeiture of their unused Health FSA contributions at the end of each year might consider updating their plan documents to allow a grace period of 2.5 months or a carryover of \$500 into the following year.