

One Minute Memo[®]



IRS Issues Guidance on Impact of Health FSA Carryovers on HSA Eligibility

By Joy Sellstrom and Kelly Pointer

On February 12, 2014, the Office of Chief Counsel of the Internal Revenue Service (the "Service") issued a *Memorandum* on the impact of health care flexible spending account ("FSA") carryovers on an individual's eligibility to contribute to a Health Savings Account ("HSA").

The Service also issued a Chief Counsel Memorandum regarding correction mechanisms for improper reimbursements from health care FSAs on the same date. The guidance in the Memorandum is consistent with the Service's prior guidance on this topic. For a copy of the Chief Counsel Memorandum, please click [here](#).

Background on \$500 Carryover

Toward the end of 2013, the Service published Notice 2013-71 announcing an optional carryover feature for health care FSAs. (See our prior *Management Alert*) Pursuant to this Notice, plans may be amended to allow up to \$500 of unused FSA account balances to be carried over to the next plan year in order to pay for qualified expenses incurred in that subsequent plan year. The carryover option will apply at the discretion of the employer and is permitted only if the plan does not include the previously established grace period rule. (Under the grace period rule, a plan may permit an employee to use account balances remaining at the end of the prior year to pay expenses incurred during the 2½ month period following the end of the plan year.) If an employer amends its plan to adopt a carryover, the same carryover limit must apply to all plan participants.

The Chief Counsel Memorandum addressed only the \$500 carryover. It did not provide further guidance on the impact of the 2½-month grace period on HSA eligibility.

Impact of Carryover on HSA-Eligibility

For many employers the \$500 carryover was a welcome alternative to the grace period to mitigate the effect of the use-or-lose rule when the carryover was announced last year. It was, however, unclear how the carryover integrated with the eligibility rules for HSAs. To be eligible to contribute to an HSA, an individual must be enrolled in a high-deductible health plan and have no other health coverage.

Further, an individual who is covered by a general purpose health FSA is not an eligible individual for purposes of making contributions to an HSA. The Chief Counsel Memorandum confirmed that this includes an individual who has coverage in a general purpose FSA solely as the result of a carryover. The Service also confirmed that this individual will be considered as having general purpose FSA coverage for the entire subsequent plan year. Therefore, the individual will be ineligible to make HSA contributions for the entire plan year, without regard to when during the year the carryover dollars are drawn down to \$0.

Carryover Plan Designs That Allow HSA Eligibility

The Chief Counsel Memorandum also describes optional plan features that an employer can include in its cafeteria plan to accommodate employees who have a general purpose FSA in one year and wish to be HSA-eligible in the following year. One option is to allow employees to decline or waive their carryover dollars. Two other options are available for cafeteria plans that offer both general purpose and limited purpose or post-deductible FSAs (click [here](#) to see our alert describing these HSA-compatible FSAs).

- A plan may allow employees to elect to contribute their carryover dollars from a general purpose FSA to a limited purpose or post-deductible FSA; or
- A plan may deem employees who elect coverage under a high-deductible health plan as automatically enrolled in the limited purpose or post-deductible FSA and apply any general purpose FSA carryover dollars to the limited purpose FSA or post-deductible FSA.

The first provision seems to apply on an individual, participant-by-participant basis, while the second seems to apply uniformly to all participants, without regard to whether they wish to be HSA-eligible.

During the claims run-out period for the general purpose FSA, the unused general purpose FSA dollars may be applied toward general medical expenses incurred prior to the end of the general purpose FSA plan year. After the run-out period expires and the carryover amount is finalized, any timely-submitted claims under the limited purpose or post-deductible FSA in excess of the elected amount may be reimbursed from the carryover amounts.

Conclusion

IRS Notice 2013-71 provides that a plan must be amended before the end of the plan year from which amounts will be carried over (with a special transition rule for 2013). The Chief Counsel Memorandum provides employers with helpful guidance on the options available to employers who want to offer health FSA carryovers.

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