



June 8, 2012

## New \$2,500 Contribution Limit to FSAs under Health Care Reform

The Patient Protection and Affordable Care Act (PPACA or ACA) established a \$2,500 limit on employees' salary-reduction contributions to a health flexible spending account (health FSA), effective **January 1, 2013**.

On May 30, 2012, the Internal Revenue Service (IRS) published *Notice 2012-40*, which clarifies that this limit applies for the health FSA *plan year* and will not affect any plan year beginning before January 1, 2013.

- *For calendar year plans (January 1 to December 31)*, including HealthFlex and most annual conference health plans: the \$2,500 limit will apply starting January 1, 2013.
- *For plans whose year begins any date after January 1*: the \$2,500 limit will begin on the first day of the plan year following January 1, 2013. For a July 1 to June 30 plan year, for example, the \$2,500 limit would apply starting July 1, 2013.

*Notice 2012-40* also clarifies other operational and administrative effects of the limit, as described below.

### Health FSAs Only

The \$2,500 limit applies only to health FSAs. It does *not* apply to dependent care flexible spending accounts, health savings accounts (HSAs), health reimbursement arrangements (HRAs), or employee salary reduction contributions through cafeteria plans used to pay the employee portion of premiums or required contributions for health plan coverage.

### Employee Contributions Only

The \$2,500 limit applies only to an employee's pretax contributions to a health FSA. Employer contributions (e.g., matching contributions) and employer-provided "flex credits" that can be used only to purchase nontaxable benefits do not count toward this limit. However, flex credits available in cash are treated as employee pretax contributions, and are therefore subject to the \$2,500 cap.

### Applies to Each Employee

*Notice 2012-40* confirms that the limit applies separately to *each* employee and health FSA. Thus, for married spouses who both work for the same employer (or in the case where there is an annual conference FSA: for churches in the same annual conference), *each* spouse could contribute \$2,500 to his or her separate health FSA. However, this would not be the case if one spouse were covered as a primary participant and the other as a dependent (because a dependent does not have an independent right to contribute to his or her own health FSA within the plan). Similarly, if an individual works for two unrelated employers and is eligible for an FSA through each employer, that person may contribute \$2,500 to *each* employer health FSA.

### Grace-Period Carryovers Excluded

Funds carried over from one plan year to the next under a plan's grace period do not count toward the \$2,500 limit in the subsequent plan year. Under *Notice 2005-42*, the allowed 2.5-month grace period for a calendar-year plan would be from January 1 to March 15 of the year following the end of the calendar year.

### Correction of Reasonable Errors

Salary reductions that exceed the \$2,500 limit because of a reasonable mistake—not willful neglect—will not violate the cafeteria plan rules if the mistake is corrected later. Correction means that the excess funds are returned to the employee as taxable wages for the year in which the error occurred and are reported on the employee's *Form W-2* for the year in which the correction is made.

### Plan Amendments Required by December 31, 2014

The cafeteria plan rules under Internal Revenue Code Section 125 require a health FSA to be part of a written cafeteria plan document. Although the cafeteria plan rules generally prohibit retroactive modification of written cafeteria plan documents, *Notice 2012-40* permits plan sponsors to amend health FSA plan documents through **December 31, 2014** to reflect the \$2,500 salary-reduction limit. Under this relief, a plan sponsor could amend its health FSA document on December 31, 2014 retroactive to January 1, 2013. However, health FSA operations must adhere to the limit once it takes effect for a plan year, which is likely to predate the amendment deadline, i.e., **January 1, 2013** for most annual conference health FSAs including FSAs through HealthFlex.

### Inflation Increases

The \$2,500 limit will be indexed for cost-of-living adjustments for plan years beginning after **December 31, 2013**.

### Public Comments Invited on “Use-it-or-Lose-it” Rule

The IRS also has asked for public comments on whether the health FSA forfeiture rule (the “use-it-or-lose-it” rule) remains viable in light of the new \$2,500 limit and how any administrative flexibility around the rule could be structured. Comments are due by **August 17, 2012**.

### UMC Impact

Health FSAs maintained by United Methodist annual conferences for clergy and lay employees must begin to comply with the new \$2,500 limit on employee contributions generally by **January 1, 2013**. Written plan documents must be amended in this regard no later than **December 31, 2014** (although amending earlier might be advisable to prevent confusion). The clarifications and administrative flexibility granted under *Notice 2012-40* regarding grace periods, employer contributions and correction of errors should make implementation of this rule relatively simple for annual conferences. HealthFlex plan sponsors who do not maintain their own independent health FSAs may rely on the General Board of Pension and Health Benefits (General Board) to comply with this rule for HealthFlex. The General Board will include more information about the limit in materials related to HealthFlex annual enrollment (AE) this fall, including AE communications to participants.

### More Information

You can read more about health care reform on the General Board's **health care reform webpage**. Please send your questions to **healthcarereform@gbophb.org**. General information about health care reform is available from the federal government at **www.healthcare.gov**.

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*This update is provided by the General Board of Pension and Health Benefits as a general informational and educational service to its plan sponsors, the annual conferences, plan participants and friends across The United Methodist Church. It should not be construed as, and does not constitute, legal advice nor accounting, tax, or other professional advice or services on any specific matter, nor does this message create an attorney-client relationship. Readers should consult with their counsel or other professional advisor before acting on any information contained in this publication.*

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