



\$2,500 Limit for Health Care Flexible Spending Accounts under the Affordable Care Act

Background

The Patient Protection and Affordable Care Act (the "Act") imposes a \$2,500 contribution limit on Health Care Flexible Spending Accounts ("health FSAs") with "taxable years" that begin after December 31, 2012¹. Prior to this statutory limit taking effect, plan sponsors had the discretion to impose limits on the amount of salary reduction contributions that employees could elect under health FSAs.

On May 30, 2012, Notice 2012-40 was released and provides long awaited clarification of the Act's statutory language regarding what constitutes a *tax year* for purposes of applying the contribution limit. This technical guidance explains that a *tax year* is defined as the *plan year* when calculating the limit.

In short, the Notice clarifies that:

1. the \$2,500 limit applies to plan years that begin on or after January 1, 2013. Clients with off-calendar plan years that start before January 1, 2013 are not required to impose the limit until the following plan year that starts in 2013;
2. the \$2,500 is a plan participant limit. In other words, a husband and wife who both work for the same employer may each elect \$2,500;
3. the \$2,500 is a plan limit. Specifically, a participant who works for two employers that are not in the same control group may elect \$2,500 under each plan;
4. grace period amounts (*i.e.*, amounts elected in a plan year that begins in 2012 that are available for the first 2 ½ months in the subsequent plan year), do not count toward the \$2,500 limit;
5. plans must be amended to reflect this change before the end of 2014;
6. a short plan year that begins on or after January 1, 2013 must impose a pro-rated \$2,500 limit on a monthly basis; and
7. employer deposits or credits to a health FSA do not count toward the \$2,500 limit unless they are credits that may be elected as cash or a non-taxable benefit, in which case they do count toward the \$2,500 limit.

The new \$2,500 limit reduces the potential for using health FSAs to defer compensation and the extent to which salary reduction amounts may accumulate over time. Given the \$2,500 limit, the Treasury Department and the IRS are considering whether the use-or-lose rule² should be modified. They are requesting comments on whether the proposed regulations should be modified to provide additional flexibility with respect to the use-or-lose rule and, if so, how any such flexibility might be formulated and constrained. Comments are also requested on how any such modifications would interact with the \$2,500 limit. WageWorks will be providing comments on this important topic.

The complete Notice is available at <http://www.irs.gov/pub/irs-drop/n-12-40.pdf> and will be in Internal Revenue Bulletin 2012-25, dated June 18, 2012.

If you have any questions about this Notice or about the Comment period for modifications to the use-or-lose rule, please contact our chief compliance officer, Jody Dietel at jody.dietel@wageworks.com.

¹ Section 125(i) was added by § 9005 of the Act, Pub. L. No. 111-148 (as amended by § 10902 of the Act, and further amended by § 1403(b) of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152).

² See Prop. Treas. Reg. § 1.125-1, Q&A-7(b) (1984); Prop. Treas. Reg. § 1.125-2, Q&A-5 & Q&A-7 (1989);

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