



Cafeteria Plans Become More User Friendly: The \$500 Rollover and the Change in Status Election Involving the Individual Mandate

LEGISLATIVE BRIEF

November 5, 2013

The purpose of this Benefit Trends is to discuss the newly published Notice on the new rollover capability under Internal Revenue Code Section 125 for health care spending accounts, as well as the special rule to accommodate employed individuals in achieving compliance with the Affordable Care Act's (ACA's) Individual Mandate.

\$500 Rollover

In 2012, the Internal Revenue Service (IRS) published **Notice 2012-40**, seeking public comment on forfeiture provisions effecting employee pre-tax contributions. The overwhelming response was to "ease the pain." In 2005, the IRS attempted to do this by allowing a plan sponsor to adopt a 2-1/2 month grace period to submit permissible expenses incurred during the grace period. Only some plan sponsors adopted the rule.

On October 31, 2013, the IRS published **IRS Notice 2013-71**, announcing a \$500 rollover provision for unused contributions to health care spending accounts (FSAs).

1. **The Rollover.** The plan may permit up to \$500 of unused pre-tax contributions to rollover into the next cafeteria plan year:

To pay claims incurred in the next plan year;

Without regard to the new plan year pre-tax election (\$2,500 maximum);

Beginning with a 2013 plan year whose subsequent plan year begins on or after January 1, 2014; and,

UNLESS the current plan year plan already contains the 2-1/2 month grace period provision.

2. **Limits on the Rollover.** The plan sponsor has discretion as to the permissible amount of the rollover, as long as it is the lesser of the unused amount (at the end of the year) or \$500. The unused amount is that amount remaining after all claims incurred are timely filed and paid under the terms of the plan.

3. **Run-out Periods.** Most plans allow participants to file valid claims incurred during the plan as long as they are filed within 90 days of the end of the plan year (e.g. March 31). The new rollover rules have no impact on this plan provision.
4. **An Accounting Rule.** If the plan uses the unused rollover amount to pay for expenses incurred in the new plan year, the plan must reduce the rollover amount first for claims incurred but not timely filed in the prior plan year.
5. **Termination of Employment.** Although not specifically addressed, it is our understanding that the rollover provision will not apply for mid-year employment termination. If the terminated employee elects COBRA (presumably to exhaust unused contributions), COBRA rights do not extend to the next cafeteria plan year. As a result, there is no new plan year available for the individual to rollover unused contributions. Additionally, the 2-1/2 month grace period provision was not available in the event of a mid-year termination of employment.

We have prepared a model amendment for plan sponsors to consider if they intend to amend their 2013 cafeteria plan documents to permit the rollover:

Cafeteria Plan Amendment: Additional of Rollover Provision

Individual Mandate: Changing a Cafeteria Plan Election

At present, putting aside the current unacceptability of the federal Exchanges' electronic enrollment nightmare, individuals must obtain minimum essential coverage no later than March 31, 2014 or pay a penalty. In anticipation of the need for individuals to change or make an election through the employer's pre-tax contribution plan, the IRS has provided transitional relief (**78 Fed. Reg. 218, 237** (Jan. 2, 2013)).

Under the transitional relief rule, Section 125 plans are permitted to allow participants to elect or revoke their participation in a salary reduction plan one time during fiscal plan years beginning in 2013, regardless of the Change in Status rules found in **IRC Section 1.125-4**. The IRS's reasoning for easing cafeteria plan Change of Status rules is twofold.

1. **Exchange Enrollment.** Some employees may wish to drop employer-provided health coverage and enroll in coverage through an Exchange (Marketplace) for coverage effective on January 1, 2014 or later. Because the Marketplace runs on a calendar year basis, employees covered under a fiscal year cafeteria plan would not have been able to make a mid-year election change without this relief. Under ACA rules, pre-tax payment of individual (Marketplace) policy premiums is prohibited.
2. **Compliance with the Individual Mandate.** Beginning in 2014, all individual taxpayers will be assessed a "shared responsibility" penalty for any months during which they or their spouse or dependents lack "minimum essential coverage" for periods beginning on or after April 1, 2014. In order to allow employees to avoid the Individual Mandate penalty, the IRS's transitional relief allows eligible employees who opted out of employer-sponsored health plan coverage in a 2013 fiscal year plan to make a one-time mid-year election change to enroll in qualifying employer-provided group health plan coverage.

Note that **IRS Notice 2013-42** also provides transitional relief for employees who are eligible but not enrolled in an employer-sponsored group health plan with a non-calendar plan year beginning in 2013 and ending in 2014. Under this guidance, these employees will not be liable for the Individual Mandate penalty until the first day of the plan year beginning in 2014.

The election changes permitted are only with regard to salary reduction elections for an employer-provided accident and health plan (pre-tax premiums). The rules do not permit election changes for health FSAs.

3. **Plan Amendment Required.** Plan sponsors choosing to allow mid-year election changes under this transitional relief must amend their written cafeteria plans accordingly. The transitional relief gives employers until December 31, 2014 to amend their plans so long as the amendment is effective retroactively to the first day of the 2013 cafeteria plan year.
Linked below is a sample Amendment for this purpose.

2013 Fiscal Plan Year Cafeteria Plan Amendment

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