

## ALERTS

### Compensation And Employee Benefits Alert - Notice 2013-71 – Internal Revenue Code Section 125 Cafeteria Plan Changes – “Use-or-Lose” Rule Modified And \$500 Carryovers Added

November 8, 2013 | [Atlanta](#) | [Chicago](#) | [Columbus](#) | [Delaware](#) | [Elkhart](#) | [Fort Wayne](#) | [Grand Rapids](#) | [Indianapolis](#) | [Los Angeles](#) | [Minneapolis](#) | [South Bend](#)

Health Flexible Spending Accounts (FSAs) under Internal Revenue Code Section 125 generally permit participating employees to make pre-tax contributions to an account from which certain medical benefits may be reimbursed. Participants in FSAs elect their pre-tax contributions before the beginning of the plan year, and the so-called “use-or-lose” rule requires any contributions not used to be forfeited. Notice 2005-42 partly mitigated the forfeiture rule by allowing a plan to provide for reimbursement of certain qualifying medical expenses incurred during a grace period of two and a half months after the end of the plan year. Contributions not used during the grace period would be forfeited.

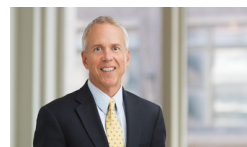
On Oct. 31, 2013, the Treasury Department and the IRS issued Notice 2013-71, which modifies the “use-or-lose” rule for FSAs and permits IRC Section 125 cafeteria plans to be amended to allow up to \$500 of unused contributions remaining in FSAs at plan year end to be reimbursed to plan participants for qualified medical expenses incurred during the following year. However, a plan that permits a carryover cannot also incorporate the “grace period” rule of Notice 2005-42. So plan sponsors that wish to adopt the carryover approach must amend their plans to provide for it, and to the extent the plans contain the grace period provisions, they must be eliminated. In sum, plan sponsors may design their IRC Section 125 cafeteria plans to (1) provide for the two and a half month post-plan year grace period, (2) permit the up to \$500 carryover of contributions to the next plan year, or (3) not permit either a grace period or a carryover.

The up to \$500 carryover option will not affect the maximum annual employee contribution of \$2,500 for health FSAs imposed under the Patient Protection and Affordable Care Act effective for plan years beginning in 2013. However, no more than \$500 can be carried over from one year to the next. The carryover option is not meant to permit for the accumulation of funds in accounts on a pre-tax basis.

Amendments to incorporate the carryover option must be adopted on or before the last day of the plan year from which amounts may be carried over and may be effective retroactively to the first day of that plan year. However, for such an amendment to be properly adopted, plan participants must be informed of the new provisions and the plan must be operated in accordance with the guidelines of Notice 2013-71. A special rule postpones the deadline for amendments for any plan year that starts in 2013 to the end of the plan year that starts in 2014.

The carryover option may temper the reluctance of moderate-income employees to participate in cafeteria plans because even modest

## RELATED PEOPLE



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forfeitures might pose a hardship. Additionally, the carryover option may counteract the tendency of plan participants to spend their contributions on potentially wasteful expenditures by plan year end.

For more information, please contact the attorney with whom you work, or the following members of Barnes & Thornburg LLP's Employee Benefits group: Michael Paton at michael.paton@btlaw.com or (317) 231-7201; Brian Lake at brian.lake@btlaw.com or (574) 237-1155; John Smarrella at john.smarrella@btlaw.com or (574) 237-1133; or Mina Amir-Mokri at mina.amir-mokri@btlaw.com or 312-214-4804.

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