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IRS Notice 2015-87 provides further guidance on health flexible spending accounts (“health FSAs”) and health reimbursement arrangements (“HRAs”) (and other topics summarized in past articles).

Health FSAs And Carryovers

Background. An employer, at its option, may amend its health FSA to allow employees to roll over up to \$500 of unused contributions to the immediately following plan year, provided the plan does not allow for a grace period.

New Guidance.

1. Unused amounts carried over from the prior year are subject to COBRA.

Example

An employer maintains a calendar year health FSA. During open enrollment, an employee elected to reduce his salary by \$2,500 for the year. In addition, the employee carries over \$500 in unused benefits from the prior year. Thus, the maximum benefit that the employee can become entitled to receive under the health FSA for the entire year is \$3,000. The employee terminates employment on May 31. As of that date, the employee had submitted \$1,100 of reimbursable expenses under the health FSA.

Conclusion: If the employee elects COBRA, the maximum benefit that the employee could become entitled to receive for the remainder of the year is \$1,900 (\$3,000 minus \$1,100).

2. Unused amounts carried over from the prior year cannot be included in the COBRA premium.

The COBRA premium for a health FSA with a carryover is based solely on the sum of the employee's salary reduction election for the year (and any employer contribution) plus the allowed 2% administration fee.

Example

An employee elects salary reduction with respect to a health FSA of \$2,000. The employer provides a matching contribution of \$1,000. In addition, the employee carries over \$500 in unused benefits from the prior year. The employee experiences a qualifying event that is a termination of employment on May 31.

Conclusion: The maximum amount the health FSA is permitted to require to be paid for COBRA continuation coverage for the remainder of the year is 102% of 1/12 of the applicable premium of \$3,000 (\$2,000 of employee salary reduction election plus \$1,000 of employer contributions) times the number of months remaining in the year after the qualifying event. The \$500 of benefits carried over from the prior year is not included in the applicable premium.

3. A health FSA must allow carryovers for COBRA continuees, subject to the same terms applicable to similarly situated non-COBRA participants.

Example

An employer maintains a calendar year health FSA. During open enrollment, an employee may elect to reduce salary by \$2,500 for the year. In addition, the plan allows a carryover of up to \$500 in unused benefits remaining at the end of the plan year. An employee elects salary reduction of \$2,500 for the year. The employee terminates employment on May 31. As of that date, the employee had submitted \$400 of reimbursable expenses under the health FSA. The employee elects COBRA continuation coverage and pays the required premiums for the rest of the year. As a qualified beneficiary, the former employee submits additional reimbursable payments in the amount of \$1,600. At the end of the plan year, there is \$500 of unused benefits remaining.

Conclusion: The qualified beneficiary is allowed to continue to submit expenses under the same terms as similarly situated non-COBRA beneficiaries in the next year, for up to \$500 in reimbursable expenses. The maximum amount that can be required as an applicable premium for the carryover amount for periods after the end of the plan year is \$0. The maximum period the carryover is required to be made available is the period of COBRA continuation coverage. In this case, the period is 18 months and terminates at the end of November of the next year. Thus, the health FSA need not reimburse any expense incurred after that November.

Note in the example above that if there were no carryover, this individual's health FSA benefits would have ended on December 31.

Due to the carryover, this individual has access to \$500 for reimbursable expenses with no additional COBRA premium charged. While this does not appear to provide the individual the right to a new COBRA election effective January 1, it does mean that employers and third party administrators ("TPAs") need to continue to monitor these accounts until the entire COBRA period expires which may increase administration costs to the plan.

4. A health FSA may condition the ability to carry over unused amounts on participation in the health FSA in the next year (and even if the ability to participate in that next year requires a minimum salary reduction election to the health FSA for that next year).

Example

Employer sponsors a cafeteria plan offering a health FSA that permits up to \$500 of unused health FSA amounts to be carried over to the next year, but only if the employee participates in the health FSA during that next year. To participate in the health FSA, an employee must contribute a minimum of \$60 (\$5 per calendar month). As of December 31, 2016, Employee A and Employee B each have \$25 remaining in their health FSA. Employee A elects to participate in the health FSA for 2017, making a \$600 salary reduction election. Employee B elects not to participate in the health FSA for 2017. Employee A has \$25 carried over to the health FSA for 2017, resulting in \$625 available in the health FSA. Employee B forfeits the \$25 as of December 31, 2016 and has no funds available in the health FSA thereafter.

Conclusion: This arrangement is permissible.

5. A health FSA may limit the ability to carry over unused amounts to a maximum period. Thus, if an individual carried over \$30 and did not elect any additional amounts for the next year, the health FSA may require forfeiture of any amount remaining at the end of that next year.

HRAs

Background. Employers can only offer HRAs that are integrated with a group health plan.

New Guidance.

1. An HRA cannot reimburse the medical expenses of an employee's spouse and/or dependents unless they are enrolled in the employer's group health plan. This is effective the first day of the 2016 plan year. However, an HRA that otherwise would be integrated based on the terms of the plan as of December 16, 2015 does not need to comply until the first day of the 2017 plan year.
2. May an HRA or similar employer-funded health care arrangement be used to purchase individual market coverage after the employee covered by the HRA ceases to be covered by other integrated group health plan coverage without causing the HRA to fail to comply with the market reforms?
 - No for the typical HRA; an HRA covering two or more current employees fails to be integrated with another group health plan if the amounts credited to the HRA may be used to purchase individual market coverage.
 - Yes if the HRA covers fewer than two participants who are current employees (such as one covering only retirees or other former employees) as the HRA qualifies as an "excepted benefit."

A participant with available funds from an HRA for any month is not eligible for a premium tax credit for that month as he is deemed to be enrolled in minimum essential coverage.

For more information, visit <https://www.irs.gov/pub/irs-drop/n-15-87.pdf>.