

## Healthcare FSA Administration with Carryover

On October 31, 2013, the U.S. Treasury Department and the IRS issued Notice 2013-71, which gives employers who offer a Healthcare Flexible Spending Account (FSA) the option of allowing employees to carry over up to \$500 of unused FSA funds to the next plan year.

Here are some of the most common questions about how WageWorks administers the Healthcare FSA carryover provision.

**1. Should I be concerned that adopting carryover will reduce my forfeitures?**

No, you should not be concerned. Employees with access to the carryover provision are more likely to participate in available benefits. This increase of enrollment can result in greater tax savings for you since employers save on every pre-tax dollar contributed to an FSA via matching social security and Medicare taxes, as well as workers compensation premiums in most states. On average employers gain more than a 7% savings on total dollars that employees put in their FSAs.

The increase in tax savings should offset any overspent money by employees leaving the company before the plan year ends or forfeiting unspent funds at the end of the plan year. Here is a savings example:

At Current Participation Rates		New Participation Rate Due to Carryover Provision	
Number of eligible employees	3000	Number of eligible employee	3000
Average FSA participation rate	25%	New participation rate	40%
Average FSA election amount	\$ 1,300	Average FSA election amount	\$ 1,300
Total employee elections	\$ 975,000	New total elections	\$ 1,560,000
Average Employer savings rate	7%	Average Employer savings rate	7%
Employer Savings	\$ 68,250	New Employer Savings	\$ 109,200
Less Annual Admin Fees	\$ 33,750	Less Annual Admin Fees	\$ 54,000
NET Employer Savings	\$ 34,500	New NET ER Savings	\$ 55,200

<b>Increase in NET ER Savings</b>	<b>\$ 20,700.00 or 60%</b>
-----------------------------------	----------------------------

\*Administration fees estimated at \$3.75 per participant per month or \$45 annually

**2. Is there any concern that an FSA will potentially become perpetual since the unused amount can be carried over indefinitely?**

No, this is not a concern. All working Americans and their families have some amount of out-of-pocket healthcare expenses every year. The average carryover amount is fairly minimal and will most likely be factored into the participants spending plan for the following year with or without additional salary deferrals. Further, as participants become more comfortable with budgeting out-of-pocket healthcare expenses, it is likely that contributed amounts will be fully used during the then current plan year. Finally, the carryover amount cannot exceed \$500.

**3. How does an employer adopt the carryover option?**

An employer must amend its plan document in writing, on or before the last day of the plan year from which amounts are to be carried over, *and* notify participants of the change.

**4. How would carryover impact a participant who changes from a full purpose healthcare FSA to a limited purpose FSA and vice versa?**

It wouldn't. Carryover, if adopted by an employer, allows amounts in a healthcare FSA—limited purpose or otherwise—to carry over into the next plan year. The carryover option will follow the participant's choice so if a participant elects a limited purpose FSA for the current plan year, and has a carryover, the carryover will follow him/her into the limited purpose FSA for the following plan year. Similarly, if the participant elects a full purpose healthcare FSA in the current plan year and has a carryover, the carryover will follow him/her into a full purpose healthcare FSA for the following plan year.

However, when a participant has elected to participate in an HDHP-qualified HSA for the following plan year, and currently has a full purpose healthcare FSA, such participant should be advised to either spend all amounts in the full purpose healthcare FSA before the end of the plan year or enroll in a limited purpose FSA for the following plan year so that he/she can start contributing to their new HSA on the first day of the following plan year.

**5. What is the difference between a 'standard' or full purpose FSA and a limited purpose FSA?**

A limited purpose FSA can only be used for vision and dental expenses. It is intended to work in conjunction with an HDHP. A standard or full purpose FSA covers all eligible medical expenses.

**6. Can an employer choose to have carryover apply to a limited purpose FSA and not a full purpose FSA? Yes, but their plan must make clear to which benefit (the full purpose healthcare FSA or the limited purpose FSA) the carryover applies.**

**7. When will the remaining prior plan year funds carryover into the new plan year?**

They will be available on the first day of the new plan year.

**8. If an employer has adopted carryover, does a participant have to have a new plan year FSA in order for the balance from the prior plan year to carryover?**

No. Any funds remaining in an individual's current year FSA will be automatically rolled in the new plan year even if such employee didn't elect to participate in the new year FSA.

**9. Can employers continue to offer the 2-1/2 month extension for dependent care?**

Yes. The carryover option only applies to healthcare FSAs. While the employer can choose to offer either the grace period or carryover provision for the healthcare FSA (but not both)—there is no reason why an employer can't offer grace period for dependent care and carryover for healthcare FSA.

**10. How does carryover impact run out?**

It doesn't. Use of the carryover option does not affect the ability of a healthcare FSA to provide for the payment of expenses incurred in one plan year during a permitted run out period at the beginning of the following plan year.

**11. Is the carryover option for healthcare only or dependent care only or both?**

The carryover option is for healthcare FSAs only and is not available for dependent care FSAs.

**12. Does the carryover amount count against the maximum contribution limit applicable to each plan year?**

No. Participants can still choose to contribute as much as the maximum contribution limit as outlined by

the IRS even if they carry over \$500 from the previous plan year.

**13. When can I adopt the carryover provision?**

Employers can adopt the carryover provision before the last date of the affected plan year.

**14. Can I offer the carryover and a grace period?**

No, employers cannot offer the grace period during the same plan year that offers the carryover provision. Employers *can* offer a grace period for a Dependent Care FSA while offering the carryover for a Healthcare FSA during the same plan year. Employers will need to amend their plan documents to:

- (1) Elect the carryover and specify related options; and
- (2) Remove the grace period, if previously adopted.

**15. What is the difference between a grace period and a carryover? Which one is better?**

Generally, WageWorks believes the carryover is a better provision because it both eliminates the rush to spend unnecessarily at the end of the plan year or grace period; and also eliminates the number one barrier to entry by those eligible employees who do not participate.

**16. Can an employer switch between offering carryover and grace period from year to year?**

Yes, an employer can make this change any year.

**17. If an employer currently has a grace period for the current plan year, can they amend their plan to offer the carryover before next year?**

The current plan can be amended before the end of the plan year to eliminate the grace period and offer the carryover provision. This change can be made at any time during the plan year.

**18. If an employer already has a grace period in their benefit plan, what action needs to be taken to change to the carryover?**

The employer would need to amend their plan to terminate the grace period and elect the carryover provision. They would need to communicate this change to all employees. You can find a sample amendment and sample employee communications at [www.wageworks.com/useitorloseit](http://www.wageworks.com/useitorloseit).

**19. Does an employer have to offer either the grace period or the carryover?**

No, you do not have to elect either option. Employers can choose to offer a carryover, a grace period or neither.

**20. Why would an employer choose a carryover instead of a grace period?**

The grace period allows unlimited unused funds to be available for use in the first two and a half months following the end of the plan year. While amounts are unlimited, the two month time frame within which expenses must be incurred still encourages a "rush to spend." Unused amounts at the end of the grace period are forfeited in total. The carryover provision allows participants to carryover unused amounts up to \$500 for use anytime during the next plan year. The carryover is only adverse to an employee with a balance greater than \$500 and eliminates the rush to spend at the end of the year. It also eliminates the most frequently cited barrier to entry by eligible employees who do not currently participate.

**21. What exactly is the grace period?**

The grace period is an additional 2-1/2 months following the close of the plan year to incur expenses against the previous plan year's election. This gives employees some "wiggle room" to use their remaining funds.

**22. Is there a minimum or a maximum amount allowed for carryover?**

Employers can choose to allow a carryover of any amount *up to* \$500 per participant per plan year. WageWorks encourages you to allow the full carryover amount. At this time, WageWorks does not support setting a minimum carryover amount per participant (e.g., participants without an available balance of at least \$x cannot have the carryover).

**23. When are carryover funds available for the employee?**

The carryover amount is available to the participant on the first day of the new plan year because of the uniform coverage requirement.

**24. What happens if an employee has a carryover balance but does not re-elect a Healthcare FSA?**

Employers can choose to allow participants who do not enroll in the new plan year to:

- (1) Forfeit their previous plan year balance rather than carry over; and/or
- (2) Default their carryover into an FSA for the new plan year.

**25. What if an employee does not re-enroll into the new plan year and also does not forfeit their carryover balance?**

If the participant does not enroll in the new plan year and does not forfeit the carryover, then an enrollment record for the new plan year will be created for that employee in the amount of a \$0 election. If the participant previously had limited coverage, they will be re-enrolled in a limited coverage account.

Otherwise, coverage in the new plan year will be a standard FSA. By opening a new record, the participant will be able to access their carryover balance on day one of the new plan year and before the end of the run-out period.

**26. Do carryover funds affect an employee's coverage?**

No. Participants who are eligible for the carryover (who have a carryover balance and did not forfeit the carryover) will have the available carryover balance transferred into the new year plan as an adjustment—with the same coverage (limited or standard) as the previous year plan.

**27. Which account will be used first—the new plan or the carryover amount from the previous plan during the run-out period?**

The current plan year will pay first and the carryover plan will pay second. Employees get the best use of their funds by having the current plan year pay first, and the previous plan year pay second.

**28. Can a participant enroll in both a standard Healthcare FSA and an HSA? Does having carryover from a standard healthcare FSA disqualify participants from contributing to an HSA?**

Having carryover doesn't disqualify participants from contributing to an HSA. Participants may enroll in a healthcare FSA and make contributions to an HSA only if the healthcare FSA is a limited-purpose healthcare FSA. A limited-purpose healthcare FSA pays only "accepted" benefits such as vision and dental expenses. This type of healthcare FSA does not preclude a participant from setting up and contributing to an HSA.

**29. Can employers give employees the option of both the healthcare FSA carryover (\$500) and a grace period?**

No. the plan cannot have a carryover and a grace period within the same plan year. The plan may only have one or the other.

**30. If we do not offer employees a limited-purpose healthcare FSA, do employees who will be enrolling in an HSA during open enrollment still need to spend their FSA funds by December 31?**

Yes. If your company does not offer a limited-purpose healthcare FSA, participants must choose to either:

- 1) Spend down their remaining healthcare FSA funds before December 31; or
- 2) Forfeit their carryover balance.

It may be a good time to revisit your plan design if you do not offer a limited purpose FSA. Remember that there are two conditions for employees to meet in order to contribute to an HSA. First, they must be enrolled in a qualified High-Deductible Health Plan. Second, they also cannot have any other impermissible coverage, which includes coverage under a spouse's health plan or FSA. Frequently, up to 50% of employees may be prevented from contributing to an FSA, so allowing them the choice between an FSA or an HSA and Limited Purpose FSA is a design that will better meet all employees' needs.

**31. What happens if a participant has a carryover balance but does not enroll in, or select, any benefit?**

If a participant has a carryover balance, the balance will roll into the type of account they have on record at the end of the plan year. If a participant does not elect a plan benefit, they will be automatically enrolled, by default, into the same plan they were enrolled in at the beginning of the previous plan year.

For example, if Jennifer was enrolled with a Limited Purpose FSA and she has a carryover balance but forgets to enroll in a new plan, she would automatically be re-enrolled in a Limited Purpose FSA. Regardless of how you ended the plan year, you will be re-enrolled in the plan you began the year with.

**32. Does this have any impact on participants enrolled in an HSA only (or their spouses)?**

No. The new carryover provision has no impact on participants who are only actively enrolled in an HSA; or any spouse enrolled in an HSA.

**33. How long can funds be carried over? Are multiple year carryovers permissible?**

Funds may be carried over indefinitely. There is no time limit. However, the employer may amend the plan to limit the years that carried over funds could be accessed. For example, an employee has unused funds from Plan Year 1, makes no election in Plan Year 2 and doesn't submit any claims for the Plan Year 1 amounts either. The employer could design their plan such that the Plan Year 1 unused amounts expire at the end of the subsequent plan year.

**34. Does the \$500 carryover affect the maximum HSA contribution amount? Does the carryover lower that total?**

Carryover funds have no effect on maximum HSA contribution amounts.

**35. As an employer, do I have to offer a limited-purpose FSA, or is an HSA sufficient?**

You have the choice to offer your employees either:

- a. A limited-purpose FSA, standard healthcare FSA and an HSA;
- b. Just an HSA; or
- c. Just a limited-purpose FSA; or
- d. Just a standard healthcare FSA

**36. What if we offer an HSA from a company other than WageWorks? Can we still offer the limited-purpose FSA through WageWorks?**

Yes. You may have single or multiple accounts with WageWorks. We work with several HSAs across all other platforms.

**37. If a participant has a limited-purpose FSA through their employer and the spouse has a limited-purpose FSA through their employer, can we both carry over \$500 for a total of \$1,000?**

Yes. They are both eligible to carry over the full amount individually for a total carryover amount of

\$1,000, provided both employers offer the carryover provision.

**38. If an employee has a carryover but quits before they have used their funds, is that money then forfeited? Or will the employee still have a period of time to submit receipts for treatment date of service prior to termination?**

If year-to-date contributions exceed claims and there is a remaining balance, the employee has a COBRA election available for the remainder of the plan year. If they do not elect COBRA then expenses can only be submitted up to the termination date.

**39. If an employee with carryover is terminated midyear, can they take the funds with them?**

Carryover funds are nontransferable. Funds would be forfeited.

**40. Under what circumstances do carryover funds go to forfeiture?**

There are two situations where carryover funds would be forfeited:

- a. If an employee quits or is terminated and does not elect COBRA, any unused funds will be forfeited. Unused amounts are subject to COBRA rights and coverage.
- b. If an employee has more than \$500 in carryover funds—any amount over \$500 will be forfeited.

**41. What can employers use forfeitures for?**

Forfeiture rules are complex. Please contact your Relationship Manager to discuss your options.

Forfeitures are generally used to pay for expenses related to plan administration.

**42. If an employer has a non-calendar year plan year do they still have to notify WageWorks by the end of the calendar year if they want to elect the carryover?**

No. The change must be adopted on or before the last day of the plan year from which amounts are to be carried over.

**43. When can a fiscal year plan make the change?**

At any time on or before the last day of the plan year from which amounts are to be carried over.

**44. Does an employer have to elect the full FSA plan limit to allow for the \$500 carryover or does the \$500 carryover apply to any plan maximum?**

The carryover provision could apply to any plan maximum.

**45. To be eligible to carryover funds, does an employee have to actively re-enroll for an FSA in the new year?**

No. An employee who does not actively elect an FSA for the new plan year but who still has funds available for carryover will be automatically re-enrolled in the plan they began the previous plan year. Their election amount will be set to \$0.

**46. Does an employer have to re-elect the carryover provision each year or does it remain in place until they actively elect to change it?**

Once an employer elects the carryover provision it would stay in place until the employer actively amends the plan again.

**47. Is there a time frame every year for the employees' carryover funds to be used?**

No. The carryover funds can be used at any time for expenses incurred in the new plan year (in addition to the elected payroll deductions). If any funds remain at the end of the current plan year, up to \$500 is carried over into the subsequent year, indefinitely.

**48. How do employers track carry over funds vs. current year dollars being utilized?**

Carryover funds will remain in the previous plan year account to pay for claims through the end of that plan's run-out period. Fifteen days after the claims deadline, the carryover funds will be transferred to the new plan year account. Before the carryover transfer occurs, if the participant exhausts their new plan year account balance, new plan year expenses will be paid from the carryover funds out of the previous plan year account automatically (both via claims and card transactions at the point of sale).

Employers will see the carryover funds represented as part of the available balance in the previous plan year account before the carryover transfer and as part of the available balance in the new plan year account after the carryover transfer. The employer website will still allow visibility into carryover spent, carryover balance and carryover transferred for each participant.

**49. Employers must ask employees to make an election to carryover funds either to a limited purpose or a 'standard' FSA. Couldn't employers determine what is best for the employee instead of requiring an explicit election?**

No. Employers must offer their employees the option to re-enroll in an FSA or forfeit their funds. Employers do not have to offer both FSA options. They can choose to offer one or the other, but they cannot make the choice for their employees.

**Still have questions? Please contact your WageWorks Account or Relationship Manager for more information.**