the Reformant™ Client Edition

June 2012 Update

The Patient Protection and Affordable Care Act, enacted on March 23, 2010, includes a significant number of health insurance and coverage provisions that must be considered and, when applicable, implemented at various points in time within the current decade. The Reformant helps employers understand how these changes influence benefits administration.

Health FSA Limit & Non-Calendar Year Plans:

New guidance eases impending administrative woes

On May 30, 2012, the IRS issued new guidance regarding the $2,500 annual limit on Health FSA salary reduction contributions imposed by Health Care Reform. This guidance resolves the administrative complexity presented by one potential component of the impending change while also providing useful information about other aspects of the change.

Round Peg Meet Round Hole

Most significantly, this guidance clarifies an issue that non-calendar year plans have been grappling with in 2012. The original provision, as written, positioned the limit as effective for "taxable years beginning after December 31, 2012". Thus, non-calendar year plans were faced with the challenge of how to easily and accurately monitor year-over-year Health FSA participation to prevent elections from exceeding the limit (and to do so in a manner that did not thoroughly confuse participants). This issue was to be especially prominent in Year One, as elections for the 2012-2013 period could be allowed without cap restraint. It was the classic, "square peg, round hole" conundrum, and it was about to get ugly when paired with the general concept of having to introduce the limit.

The most recent IRS guidance indicates the $2,500 limit applies on a **plan year basis** and is effective **for cafeteria plan years beginning after December 31, 2012**. This change minimizes the issue of having to regulate non-calendar year elections against the calendar tax year.

OTHER PLAN YEAR CONSIDERATIONS

For plans running a short plan year, the guidance indicates that the limit must be prorated. The limit also is indexed for cost-of-living adjustments for plan years beginning after December 31, 2013.

OTHER NOTABLE CLARIFICATIONS

The IRS used Notice 2012-40 as an opportunity to clarify several other items pertaining to the impending Health FSA annual limit. **These clarifications are outlined within the table that appears on the following page.**

NOTEWORTHY

The Notice also indicated the IRS and Department of the Treasury are considering whether the "use-it-or-lose-it" rule should be modified for the limited $2,500 Health FSA world. Public commentary was requested.

In the Reformant Spotlight:

PROVISION:
$2,500 Limit on Health FSA Salary Reductions
IRS Notice 2012-40

APPLIES TO:
All group health plans that offer a Health FSA benefit to employees, with particular applicability to non-calendar year plans.

EFFECTIVE DATE:
Plan Years beginning after December 31, 2012

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Health FSA $2,500 Limit Guidance (June 2012 Update)

$2,500 HEALTH FSA LIMIT EFFECTIVE PLAN YEARS BEGINNING AFTER DECEMBER 31, 2012	
Key Guidance from IRS Notice 2012-40, released May 30, 2012	
Plan Year Applicability	The $2,500 limit applies on a plan year basis.
Limit Per Employee	The limit applies on a per employee basis. An employee and a spouse that have the same employer and participate in the same Health FSA program can each elect up to the $2,500 limit.
Grace Period Applicability	When a grace period is provided, carry over amounts used during the grace period count toward the limit only in the plan year for which the contributions were made (they do not count toward the limit in the subsequent plan year).
Correcting Excess Contribution Issues	In situations where employees are allowed to exceed the limit in error, the IRS will provide relief if the excess contributions result from a reasonable employer mistake and are refunded to the affected employees and reported as wages by a specified date.

Next Steps

With the plan year vs. tax year obstacle now out of the way for non-calendar year plans, we anticipate that employers sponsoring such plans will leverage the post-2012 effective date and allow Health FSA participants to enroll this plan year to the current limits. Looking ahead to the actual implementation for plan years situated at January 1, 2013 and beyond, strategic planning will be focused on the following:

> **Employee/Participant Education** - Benefits communications strategies will need to be augmented to profile the key components of this change. Introducing the limit itself is the big ticket item, but plan sponsors should also focus upon educating employees about the per employee limit and grace period implications. The employee limit provides a positive spin opportunity that can be used to help buffer the communication of a new benefit limitation, a perceived negative especially among participants already leveraging amounts greater than the limit.
>
> Also, plans that sponsor $2,500+ Health FSAs today can and should consider supporting advanced pre-enrollment communications campaigns targeted at the current $2,500+ enrollees.

> **Enrollment Process Modification** - Enrollment tools, materials and processes will need to be modified to prevent employees from being able to elect any amount greater than the limit for both short and traditional plan years. These limits will need to be modified and tested on an annual basis as the limit is adjusted by the IRS.

> **Plan Documentation** - Plan documents must be amended to reflect the $2,500 limit. Plan sponsors have until December 31, 2014 to amend their plans to conform to the new requirements, so long as the amendment is effective retroactively and the plan operates in compliance for plan years beginning after December 31, 2012.

THE LAST WORD...FOR NOW!

While not the norm, we certainly welcome situations like this where new guidance eliminates administrative obstacles. We will continue to monitor developments in this area in order to be prepared to effectively support the requirements and strategically engage with our clients about this subject during future planning sessions.

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