

New limitation placed on health flexible spending arrangements (FSAs) offered in cafeteria plans.

For tax years beginning after Dec. 31, 2012, a health FSA will be considered a “non-qualified benefit” under a cafeteria plan unless the plan provides for a \$2,500 maximum annual salary reduction contribution to the FSA. If the plan does not specifically prohibit salary reductions in excess of \$2,500, the benefit under the health FSA will be “non-qualified”. Under such circumstances, an employee will be subject to tax on distributions from the health FSA, thereby eliminating the tax benefits of health FSA contributions, including those under \$2500.

After 2013 this dollar limit will be adjusted annually for inflation. Any inflation adjustment that is not a multiple of \$50 will be rounded down to the next lowest multiple of \$50.

The new limitation does protect employees from large forfeitures and does protect employers from employees who game the system by signing up for large amounts, submitting large claims early in the year and then terminating employment, leaving the employer stuck with the bill.

Action: Employers will need to review the plan documents. If a change is required: amend the document, provide advance notice to employees and consult with any service provider.

