

HEALTH REFORM IMPACT

What you need to know NOW

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Health Reform Legislation Unexpectedly Limits Health Flexible Spending Arrangements

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Health flexible spending arrangements (“Health FSAs”) have become a very popular benefit for employees in recent years. As a result, most employers offer these arrangements as part of their overall benefit programs. While the recently enacted health reform legislation has greatly expanded access to health insurance and increased the benefits which must be offered to employees under group health plans, the legislation unexpectedly makes changes regarding the administration of Health FSAs that significantly limit an employee’s use of these arrangements.

The first change, effective January 1, 2011, prohibits the reimbursement of the costs of over the counter medications purchased without a prescription (other than insulin) from an employee’s Health FSA.¹ This change overrules previous guidance issued by the Internal Revenue Service, which permitted the reimbursement of such expenses, and may come as a surprise to employers and employees alike given the relatively recent issuance of this guidance. In addition, it is unclear at this time what impact this change will have on the use of debit cards in connection with Health FSAs. Since over the counter medications may no longer be reimbursed under a Health FSA, employers and third party administrators may find it necessary to issue new debit cards to employees or otherwise develop new procedures to enforce this prohibition. We expect that forthcoming regulations will address this issue, given the widespread use of debit cards in connection with Health FSAs.

The second change, effective January 1, 2013, limits the annual amount that an employee may contribute to his or her Health FSA to \$2,500.² Previously, there was no monetary limit on these contributions. Interestingly, the text of the health reform legislation appears to apply the \$2,500 limit exclusively to an employee’s “salary reduction contributions” suggesting that employer contributions to an employee’s Health FSA (such as matching contributions) are permitted to exceed the \$2,500 limit. Forthcoming regulations should clarify this issue as well.

The health reform legislation will have a significant impact on the administration of Health FSAs. With the effective dates of these changes quickly approaching, employers should begin

¹ This prohibition also applies to reimbursements from an employee’s health savings account (“HSA”), Archer medical spending account (“Archer MSA”) or health reimbursement account (“HRA”).

² The \$2,500 limit on employee salary reduction contributions will be increased for cost of living adjustments.

reviewing their programs now to ensure timely compliance with the legislation. Needed actions will include amending plan documents and updating participant communications to reflect the changes. In addition, employees will need to carefully consider their elections in the upcoming open enrollment period to take into account these new limitations. Failure to do so could result in the employees forfeiting contributions under the “use it or lose it” provisions applicable to Health FSAs.

If you have questions regarding the information in this client alert, or with respect to other provisions of the health reform legislation as it relates to your employee benefit plans, please contact any of the attorneys in our Employee Benefits Practice Group listed below.

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