

Employer FAQ: Flexible Spending Accounts

What's a FSA?

A flexible spending account (FSA) is a benefit you sponsor for your employees. A flexible spending account lets your employees set aside pre-tax dollars to pay for eligible expenses like healthcare and/or dependent care, depending on plan type.

What are the different types of FSAs available?

Healthcare FSA With a healthcare FSA, your employees can pay for eligible healthcare expenses on a pre-tax basis, which reduces the amount paid for federal income tax, FICA tax and, as applicable, their state income taxes. Healthcare FSAs cover an extensive list of eligible, reimbursable expenses, as defined by IRS Code Section 213(d).

Dependent Care FSA Dependent care FSAs (DCAs) gives your employees the ability to pay for work-related dependent care expenses with pretax dollars, which allows them to save on federal income tax, FICA tax and, as applicable, their state income taxes. DCAs may provide your employees more tax advantages than the federal income tax credit.

Limited-Purpose FSA If you offer an HSA-compatible high-deductible health plan paired with a health savings account (HSA), you may offer only a limited-purpose FSA to those employees that have an HSA. The limited-purpose FSA is designed to complement the HSA and may be established to pay for eligible vision and dental expenses. Medical expenses are not permitted, because the tax-favored HSA is used to fund those costs.

Who can offer an FSA plan?

Most employers can offer an FSA, with a few exceptions. You may want to check with your legal or tax advisor regarding your specific situation.

Who may contribute to an FSA?

Employees contribute to their own FSA through pre-tax salary deduction. You can also contribute money to your employees' FSAs.

Can an FSA be offered with any health plan?

Yes. An FSA plan can be offered alongside any medical or dental plan. However, according to IRS regulations, if employees contribute to an HSA, they can only enroll in a limited-purpose FSA.

What regulations should I be aware of?

Healthcare FSAs are governed by Internal Revenue Code Section 125 when offered through a cafeteria plan. If the healthcare FSA isn't offered through a cafeteria plan it's subject to Internal Revenue Code Section 105. Usually they're subject to ERISA, COBRA and HIPAA laws.

Can I offer my employees a grace period option?

Yes. The grace period allows employees up to two months and fifteen days beyond the end of the plan year to use their contributed funds. This lets employees incur and submit reimbursement requests using the previous year's FSA balance. In the case of a calendar year plan, the grace period may extend to March 15 of the following year. Expenses from January 1 through March 15 can be reimbursed from the previous year's FSA.

How does the grace period affect employees' ability to contribute to an HSA?

An employee who's enrolled in a healthcare FSA with a grace period can contribute to an HSA if there's no money left in the FSA at the end of the plan year or they've reached the end of the grace period.

Can owners or partners participate in an FSA?

No. According to IRS guidelines, anyone with two percent or more ownership in a schedule S corporation, LLC, LLP, PC, sole proprietorship, or partnership may not participate. C-corporation owners and their families are eligible to participate in FSA plans because they are considered to be W-2 common law employees.

Do non-discrimination rules apply?

Yes. Based on requirements set by the Internal Revenue Service (IRS) Section 125 Cafeteria, flexible spending accounts cannot discriminate in favor of highly compensated or key employees. To ensure that employers are in compliance with these rules, non-discrimination testing is required annually.

Is a domestic partner covered under an FSA?

Medical expenses of a domestic partner who is a tax dependent of the employee are eligible for tax-free reimbursement from the employee's health FSA. Medical expenses for a domestic partner who is not the employee's tax dependent are not eligible for tax-free reimbursement from the employee's health FSA, even if the employer offers domestic partner health insurance benefits.

What options does an employer have with unused FSA funds?

Employers can either use leftover funds to apply to administrative costs incurred during the plan year or give it back to employees by crediting it to employees' FSAs in the next plan year. The latter option can occur only if the funds are allocated on a uniform and reasonable basis to all of the FSA plan participants.

Is the employer taxed on unused funds that are forfeited from an employee's FSA?

No, the employer is not taxed on unused funds.

Can an employer charge an employee for the balance of a healthcare FSA if the employee leaves employment mid-year?

No. The Uniform Coverage Rule does not allow employers to charge an employee for the balance of an FSA if he or she terminates mid-year. The rule indicates that the maximum amount of reimbursement from a healthcare FSA must be available at all times during the coverage period. The uniform coverage rules prohibit an employer from designing a plan that ties the maximum amount of reimbursement at any particular time to the amount the employee has contributed. Similarly, the employee contribution payment schedule for the required amount for coverage under a healthcare FSA may not be based on the rate or amount of covered claims incurred during the coverage period. Employee salary reduction payments must not be accelerated based on the employee's incurred claims and reimbursements.

How can employers limit risk of loss associated with early terminations?

Employers assume a level of risk similar to that the employee takes under the use-or-lose rule. Potential forfeitures offset the risk of early termination losses for many employers. Flexible plan design options allow you to limit your risk.