



F E B C O

Benefits Consultants

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What can employers do with health FSA forfeitures?

As a reminder, what are called "forfeitures" from a participant's perspective can turn into "experience gains" for the health FSA overall. An experience gain will only arise for a plan year if the health FSA "premiums" received from employees (e.g., salary reductions) for that year exceed total reimbursements. Consequently, you will not know until next year (after the end of the applicable run-out period) whether your health FSA will even have an experience gain that can be used for anything.

Meanwhile, you should explain to your participant that the tax laws only allow employers to use health FSA experience gains for the following purposes:

1. to pay for the plan's reasonable administrative expenses,
2. reduce premiums,
3. provide a refund, or
4. increase coverage in the following year.
5. Also, the DOL considers salary reductions used to pay for health coverage provided by ERISA-covered employers to be ERISA plan assets, which must be used exclusively for the participants' benefit or to pay expenses--they cannot be forfeited to the employer (e.g., they cannot be used by the employer for general business purposes).

One other thing to remember is that, although the inquiring participant may have forfeited his or her account balance, depending on the health FSA's experience for all participants combined, there might be no overall experience gains to give back to any participants.

If you want to use experience gains arising from salary reduction contributions to pay health FSA administrative costs, you must maintain detailed records that at least show the date, amount and nature of the expense and clearly show that it relates to the health FSA.

Using experience gains to pay the health FSA claims processing fee of a dedicated third-party administrator or other service provider is relatively straightforward to document.

If you choose not to use experience gains to pay administrative costs (or if gains are left over after paying for such costs), then you should allocate those gains to your health FSA participants on a "reasonable and uniform basis." Prop. Treas. Reg. Sec. 1.125-2, Q/A-7(b)(7).

One way is to use the gains to reduce premiums for the following year (e.g., you might provide the same \$2,400 worth of health FSA coverage for a reduced (\$2,300) level of salary reductions).

A second option is to return such gains to your participants as dividends or premium refunds, which would constitute taxable wages (e.g., you could cut checks to all participants, allocating the experience gain on a per capita basis weighted to reflect the participants' elected levels of coverage).

We also think that a third option exists, although not mentioned in the regulations--increasing the annual coverage amount for the following year, which would have the same economic effect as reducing premiums (e.g., increase the \$2,400 coverage to \$2,500, for the same (\$2,400) salary reductions). (If you desire this option, make sure that your plan document is drafted to allow the plan limit to be exceeded under these special circumstances.)

No matter which option you use, remember one important caution: "[I]n no case may the experience gains be allocated among premium payers based (directly or indirectly) on their individual claims experience." Prop. Treas. Reg. Sec. 1.125-2, Q/A-7(b)(7).