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**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Joseph Tiberio, Manager
(SB/SE Employment Tax Policy)
SE:S:SP:ET:ETP

from: Harry Beker, Chief
(Health and Welfare Branch)
CC:TEGE:EB:HW

subject: Health Flexible Spending Arrangement (health FSA) Carryovers and Eligibility for a Health Savings Account (HSA)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

- (1) May an otherwise eligible individual under section 223(c)(1)(A) of the Internal Revenue Code (the Code) contribute to an HSA if the individual participates in a general purpose health FSA solely as the result of a carryover of unused amounts from the prior year?
- (2) May an otherwise eligible individual under section 223(c)(1)(A) of the Code who participates in a general purpose health FSA solely as the result of a carryover of unused amounts from the prior year contribute to an HSA for any month after all of the carried over health FSA amounts are paid or reimbursed for medical expenses?
- (3) May an individual who participates in a general purpose health FSA and elects, for the following year, to participate in an HSA-compatible health FSA (that is, a limited purpose health FSA, a post-deductible health FSA, or combination of

both) also elect to have any unused amounts from the general purpose health FSA carried over to the HSA-compatible health FSA?

- (4) May an individual who participates in a general purpose health FSA and elects for the following year to participate in an HSA-compatible health FSA and have any unused amounts from the general purpose health FSA carried over to the HSA-compatible health FSA also contribute to an HSA during the following year if the individual is otherwise eligible under section 223(c)(1)(A) of the Code?
- (5) May a cafeteria plan that offers both a general purpose health FSA and an HSA-compatible health FSA automatically treat an individual who elects coverage in a high deductible health plan (HDHP) for the following year as enrolled in the HSA-compatible health FSA and carry over any unused amounts from a general purpose health FSA to the HSA-compatible health FSA for the following year?
- (6) If a cafeteria plan provides that an individual who participates in a general purpose health FSA that provides for a carryover may decline the carryover for the following year, may the individual who so declines contribute to an HSA during the following year if the individual is otherwise eligible under section 223(c)(1)(A)?
- (7) If an individual elects to carry over unused amounts from a general purpose health FSA to an HSA-compatible health FSA, how do the uniform coverage rules which require the maximum reimbursement from a health FSA to be available at all times during the period of coverage apply during the run-out period of the general purpose health FSA?

LAW AND ANALYSIS

Section 223(a) of the Code allows a deduction for contributions to an HSA for an “eligible individual.” Section 223(c)(1)(A) defines “eligible individual” with respect to any month, as an individual who, in addition to other requirements, is covered under a High Deductible Health Plan (HDHP) on the first day of such month and is not, while covered under the HDHP, “covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan.” An eligible individual may also have permitted insurance, and certain disregarded coverage in addition to an HDHP. A plan does not fail to be treated as an HDHP merely because it covers preventive care without a deductible. Therefore, under section 223, an individual who is eligible to contribute to an HSA must be covered by a health plan that is an HDHP, and may also have permitted insurance, permitted coverage and preventive care, but no other coverage.

A health FSA that reimburses all qualified section 213(d) medical expenses without other restrictions is a health plan that constitutes other coverage. Consequently, an individual who is covered by a health FSA that pays or reimburses all qualified medical

expenses is not an eligible individual for purposes of making contributions to an HSA. See Notice 2005-86 (2005-49 IRB 1075). This disqualification includes the entire plan year, even if the health FSA has paid or reimbursed all amounts prior to the end of the plan year. See Notice 2005-86.¹

Notice 2013-71 (2013-47 IRB 532) permits a cafeteria plan to provide for the use of up to \$500 of any amount remaining unused in a health FSA in the immediately following plan year. This is in contrast to a run-out period, which is a period after the end of the plan year during which a participant can submit a claim for reimbursement for a qualified benefit incurred during the plan year. See Proposed Treas. Reg. §1.125-1(f). Notice 2013-71 provides that a cafeteria plan is permitted to treat reimbursements of all claims for expenses that are incurred in the current plan year as reimbursed first from unused amounts credited for the current plan year and, only after exhausting these current plan year amounts, as then reimbursed from unused amounts carried over from the preceding plan year.

ISSUE 1

An individual who is covered by a general purpose health FSA that pays or reimburses all qualified medical expenses is not an eligible individual for purposes of making contributions to an HSA. This includes an individual who has coverage in a general purpose HSA solely as the result of a carryover of unused amounts in a health FSA from the prior year.

ISSUE 2

An individual who is covered by a general purpose health FSA that pays or reimburses all qualified medical expenses is not an eligible individual for purposes of making contributions to an HSA during the entire plan year of the health FSA without regards to the amount available from the health FSA for any month during the plan year. Thus, an individual covered by a general purpose health FSA solely as the result of a carryover of unused amounts in a health FSA may not contribute to an HSA even for months in the plan year after the health FSA no longer has any amounts available to pay or reimburse medical expenses.

ISSUE 3

¹ Notice 2005-86 provides that an individual participating in a health FSA who is covered by the grace period is generally not eligible to contribute to an HSA until the first day of the first month following the end of the grace period, even if the participant's health FSA has no unused benefits at the end of the prior cafeteria plan year. While subsequent legislation enacted section 223(c)(1)(B)(iii)(I) which treats coverage during a grace period as disregarded coverage if the year-end health FSA balance is zero, implicit in that provision is that the period prior to the end of the year is still disqualifying coverage. See the Tax Relief and Health Care Act of 2006 (Pub. L. 109-432).

An individual who participates in a general purpose health FSA and elects, for the following year, to participate in an HSA-compatible health FSA may elect to have any unused amounts from the general purpose health FSA carried over to the HSA-compatible health FSA. There is no requirement that the unused amounts in the general purpose health FSA only be carried over to a general purpose health FSA. However, the carryover amounts may not be carried over to a non-health FSA or another type of cafeteria plan benefit.

ISSUE 4

An individual who participates in a general purpose health FSA and elects, for the following year, to participate in an HSA-compatible health FSA and have any unused amounts from the general purpose health FSA carried over to the HSA-compatible health FSA is eligible to contribute to an HSA during the following year if the individual is otherwise eligible under section 223(c)(1)(A).

ISSUE 5

A cafeteria plan that offers both a general purpose health FSA and an HSA-compatible health FSA may automatically treat an individual who elects coverage in an HDHP for the following year as enrolled in the HSA-compatible health FSA and carry over any unused amounts from a general purpose health FSA to the HSA compatible health FSA for the following year.

ISSUE 6

A cafeteria plan may provide that if an individual participates in a general purpose health FSA that provides for a carryover of unused amounts, the individual may elect prior to the beginning of the following year to decline or waive the carryover for the following year. In that case, the individual who declines under the terms of the cafeteria plan may contribute to an HSA during the following year if the individual is otherwise eligible under section 223(c)(1)(A).

ISSUE 7

If an individual elects to carry over unused amounts from a general purpose health FSA to a HSA-compatible health FSA, the uniform coverage rules may be applied during the run-out period of the general purpose health FSA as follows:

During the run-out period for the general purpose health FSA, the unused health FSA amounts may be used to reimburse any allowed section 213(d) medical expenses incurred prior to the end of the general purpose health FSA plan year. Any claims covered by the HSA-compatible health FSA must be timely reimbursed up to the amount elected for the HSA-compatible health FSA plan year. Any claims in excess of

the elected amount may be reimbursed after the run-out period when the amount of any carryover is determined.

Example: Employer offers a calendar year general purpose health FSA and a calendar year HSA-compatible health FSA. Both FSAs provide for a carryover of up to \$500 of unused amounts and do not have a grace period. Employee has an unused amount of \$600 in the general purpose health FSA on December 31 of Year 1. Prior to December 31 of Year 1, Employee elects \$2,500 in the HSA-compatible health FSA for Year 2 and elects to have any carryover go to the HSA-compatible health FSA. Employee also elects coverage by an HDHP for Year 2. In January of Year 2, Employee incurs and submits a claim for \$2700 in dental care covered by the HSA-compatible health FSA. The plan timely reimburses \$2,500, the amount elected. In February of Year 2, Employee submits and is reimbursed from the general purpose health FSA for \$300 in medical expenses incurred prior to December 31 of Year 1. At the end of the run-out period, \$300 in the general purpose health FSA is unused and carried over to the HSA-compatible health FSA. Employee is then reimbursed \$200 for the excess of the January claim over the amount elected for the HSA-compatible health FSA. Employee has \$100 remaining in the HSA-compatible health FSA to be used for expense incurred in the year or carried over to the next year. Employee is allowed to contribute to an HSA as of January 1 of Year 2.

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