

# COMPLIANCE OVERVIEW



## Health FSA Contribution Limit

Internal Revenue Code (Code) Section 125 imposes a **maximum dollar limit on employees' salary reduction contributions** to a health flexible spending account (FSA). This limit started off as \$2,500 for plan years beginning on or after Jan. 1, 2013, and has been adjusted for inflation for subsequent plan years. For plan years beginning on or after Jan. 1, 2022, the health FSA contribution limit is **\$2,850**.

This limit only applies to an employee's pre-tax contributions to a health FSA. Non-elective employer contributions to a health FSA (for example, matching contributions or flex credits) generally do not count toward the health FSA contribution limit. Also, the limit does not apply to employees' pre-tax contributions for other benefits, such as health insurance coverage.

Employers may impose their own limits on employee contributions to health FSAs, as long as the employer's limit does not exceed the Code Section 125 maximum limit for the plan year. Employers with health FSAs should confirm that their contribution limit is included in the plan's documents and communicated to employees at enrollment time.

### LINKS AND RESOURCES

- [Code Section 125\(i\)](#), which contains the contribution limit for health FSAs.
- IRS [Notice 2012-40](#), which includes a number of clarifications related to the health FSA contribution limit.
- IRS [Rev. Proc. 2021-45](#), which includes the inflation adjustments for 2022.

## Key Highlights

- Code Section 125 limits employees' pre-tax health FSA contributions to \$2,500 per year (as adjusted for inflation).
- The adjusted limit for 2022 plan years is \$2,850.
- This limit does not apply to employer matching contributions or flex credits.
- Employers may impose their own limit on health FSA contributions, as long as it does not exceed the Code Section 125 limit.

## Dollar Limits

- For plan years beginning in 2019, the health FSA limit was \$2,700.
- For plan years beginning in 2020 and 2021, the health FSA limit is \$2,750.
- For plan years beginning in 2022, the health FSA limit is \$2,850.

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## Limit on Salary Reduction Contributions

Code Section 125 imposes a **maximum dollar limit on employees' salary reduction contributions to a health FSA**, effective for plan years beginning on or after Jan. 1, 2013. The dollar limit started out at \$2,500, and is indexed for cost-of-living adjustments for years after 2013. For plan years beginning on or after Jan. 1, 2022, the dollar limit on employee salary reduction contributions to a health FSA is \$2,850.

Health FSA Contribution Limit	
Plan years beginning in 2014	\$2,500
Plan years beginning in 2015	\$2,550
Plan years beginning in 2016	\$2,550
Plan years beginning in 2017	\$2,600
Plan years beginning in 2018	\$2,650
Plan years beginning in 2019	\$2,700
Plan years beginning in 2020	\$2,750
Plan years beginning in 2021	\$2,750
Plan years beginning in 2022	\$2,850

According to [IRS Notice 2012-40](#), a cafeteria plan that fails to comply with the health FSA contribution limit will not receive the tax advantages of Code Section 125. This means that the value of the taxable benefits that an employee could have elected to receive under the plan during the plan year (for example, additional compensation) would be includible in the employee's gross income for tax purposes, regardless of the benefit elected by the employee.

### *Contributions Subject to the Limit*

This limit only applies to employees' pre-tax contributions to a health FSA. Non-elective employer contributions to a health FSA (for example, matching contributions or flex credits) generally do not count toward the health FSA contribution limit. However, if employees may elect to receive the employer contributions in cash or as a taxable benefit, then the contributions will be treated as salary reductions and will count toward the health FSA contribution limit.

In addition, the limit does not impact contributions under other employer-provided coverage. For example, employee salary reduction contributions to an FSA for dependent care assistance or adoption care assistance are not affected by the health FSA contribution limit. The limit also does not apply to salary reduction contributions to a Section 125 cafeteria plan that are used to pay for an employee's share of health coverage premiums, to contributions to a health savings account (HSA) or to amounts made available by an employer under a health reimbursement arrangement (HRA).

### *Per Employee Limit*

The health FSA contribution limit applies on an employee-by-employee basis. Each employee may elect only up to \$2,500 in salary reductions (as adjusted each year), regardless of whether he or she also has family members who benefit from

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the funds in that FSA. However, each family member who is eligible to participate in his or her own health FSA will have a separate limit. For example, a husband and wife who have their own health FSAs can both make salary reductions up to the health FSA limit for the year (subject to any lower employer limits).

If an employee participates in multiple cafeteria plans that are maintained by employers under common control, the employee's total health FSA salary reduction contributions under all of the cafeteria plans are limited to \$2,500 (as adjusted each year). However, if an individual has health FSAs through two or more unrelated employers, he or she can make salary reductions up to the contribution limit for the year under each employer's health FSA.

## “Use or Lose” Rule and Exceptions

Health FSAs are subject to a “use or lose” rule under Code Section 125. Under this rule, any unused funds in the health FSA at the end of the coverage period generally cannot be carried over to the next coverage period and must be forfeited. However, the Internal Revenue Service (IRS) has provided some exceptions to the “use or lose” rule for health FSAs.

### *Grace Period Exception*

A cafeteria plan may include a grace period of up to two months and 15 days immediately following the end of a plan year. If a plan includes a grace period, an employee may use amounts remaining from the previous plan year, including amounts remaining in a health FSA, to pay for expenses incurred for certain qualified benefits during the grace period. Allowing a health FSA grace period is strictly optional; the employer must choose to implement it as part of its health FSA's design. Also, a grace period under a health FSA is an alternative to offering carryovers—a health FSA that allows carryovers cannot also have a grace period.

If a health FSA is subject to a grace period, unused salary reduction contributions that are carried over into the grace period **do not count against the health FSA contribution limit** for the following plan year.

### *Carryover Exception*

Employers with health FSAs may allow **up to \$500 (as adjusted for inflation) of unused funds** remaining at the end of a coverage period to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following coverage period. Similar to health FSA grace periods, permitting carryovers is strictly optional, and employers must choose to implement it. Also, the carryover provision is only available if the plan does not also incorporate the grace period rule.

If a health FSA allows carryovers, unused salary reduction contributions that are carried over into the next plan year **do not count against the health FSA contribution limit** for the following plan year.

### *Annual Increases to Health FSA Carryover Limit*

On May 12, 2020, the IRS issued [Notice 2020-33](#) to increase the maximum \$500 carryover amount for a plan year to an amount equal to **20% of the maximum salary reduction contribution for that plan year**. For plan years beginning in 2020, the carryover limit is \$550 (20% of \$2,750, the indexed 2020 contribution limit). Employers that implement the indexing of the maximum carryover amount for 2020 must adopt an amendment to their Section 125 cafeteria plans by **Dec. 31, 2021**, which may be effective retroactively to Jan. 1, 2020, provided that the employer informs all individuals eligible to participate in the cafeteria plan of the changes to the plan. For plan years beginning in 2021, the carryover limit is also \$550 (20% of \$2,750, the indexed 2021 contribution limit). However, for plan years beginning in 2022, the carryover limit increases to \$570 (20% of \$2,850, the indexed 2022 contribution limit).

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## Compliance Mistakes

[IRS Notice 2012-40](#) provides compliance relief for certain salary reduction contributions exceeding the health FSA contribution limit that are due to a reasonable mistake and not willful neglect and that are corrected by the employer. More specifically, if one or more employees are mistakenly allowed to elect a salary reduction of more than the Section 125 limit for a plan year, the error may be corrected without causing the cafeteria plan to lose its preferential tax status if:

- ☒ The plan's terms apply uniformly to all participants;
- ☒ The error results from a reasonable mistake by the employer (or its agent) and is not due to the employer's (or agent's) willful neglect; and
- ☒ Salary reductions in excess of the ACA's limit are paid to the employee and reported as wages for income tax withholding and employment tax purposes on the employee's Form W-2.