LEGAL UPDATE

EMPLOYCO USA
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HIGHLIGHTS

- The health FSA contribution limit increases to $3,500 for plan years beginning in 2027.
- The limit on health FSA carryover increases to $700 for plan years beginning in 2027.
- Employers may impose lower limits on health FSA contributions and carryovers.
- Employers should communicate the health FSA limits to employees as part of the enrollment process.

IRS Releases Health FSA Limits for 2027

On Nov. 5, 2026, the IRS released Revenue Procedure 2026-35, which includes the 2027 inflation-adjusted limits for health flexible spending accounts (FSAs). For plan years beginning in 2027, the adjusted dollar limit on employees' pre-tax contributions to health FSAs increases to **$3,500**. This is a $100 increase from the 2026 health FSA limit of $3,400. Also, the limit on health FSA carryover increases to **$700** for 2027 plan years, up from $680 for plan years beginning in 2026.

Employers should confirm that their health FSA contribution limits for the upcoming plan year do not exceed the inflation-adjusted limits for 2027. Also, employers should communicate applicable health FSA limits to employees at enrollment time.

Contribution Limit

The Affordable Care Act imposes a dollar limit on employees' salary reduction contributions to health FSAs. This limit started at $2,500 for plan years beginning on or after Jan. 1, 2013, and has been adjusted for inflation for subsequent plan years. Employers can impose their own limit on employees' pre-tax contributions to a health FSA, provided it does not exceed the inflation-adjusted limit in effect for that year.

The dollar limit applies only to employees' pre-tax contributions to a health FSA. Nonelective 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 must be treated as salary reductions and counted toward the health FSA contribution limit.

The health FSA dollar limit applies on an employee-by-employee basis. Each employee may only elect up to $3,500 in salary reductions for the 2027 plan year, regardless of whether they have family members who benefit from the funds in that FSA. However, each family member eligible to participate in their own health FSA has a separate limit. For example, a married couple who have their own health FSAs can both make salary reductions of up to $3,500 for 2027, subject to any lower employer limits.

Carryover Limit

Health FSAs are subject to a "use-or-lose" rule that generally requires any unused funds at the end of the plan year (plus any applicable grace period) to be forfeited. As an alternative to a grace period, employers may allow participants to carry over up to $500 (as adjusted for inflation) of unused funds into the next year. The carryover amount may be used to pay or reimburse medical expenses incurred during the entire plan year to which it is carried over. Also, the carryover amount does not count toward the dollar limit on employees' salary reduction contributions to a health FSA.

The maximum carryover amount is adjusted annually so that it equals 20% of the dollar limit on salary reduction contributions to a health FSA for that plan year. For plan years beginning in 2027, the carryover limit is $700 ($680 for plan years beginning in 2026).

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