

ADVISORY BULLETIN

May 2005

- Flexible Benefit Plan Administration
- Retirement Plan Administration
- COBRA Administration



IRS JUST ANNOUNCED MORE TIME TO SPEND FSA FUNDS

In NOTICE 2005-42, released May 18th, the IRS announced modifications to Section 125 Cafeteria Plan rules.

Summary of Action

This change allows FSA participants to use an "extension" of time to incur claims for a plan year. Participants may now have as long as 14 months and 15 days (thus the "two and one half month rule"), to use up the funds in their FSA account to avoid "use it or lose it". If unused after this extension, the provisions of "use it or lose it" apply.

This extension is available immediately at the option of each plan sponsor/employer. A plan amendment must be executed prior to the end of the current plan year in order to apply to current plan participants. Please email your request to pjamrog@benstrat.com and Benefit Strategies will email you the necessary forms for your signature.

Details

- ✓ This action must be available to all plan participants, not selectively.
- ✓ This action does not meet the requirement needed to create a new open enrollment period.
- ✓ Funds remaining in the FSA cannot be transferred between health and dependent care accounts.
- ✓ The *FlexExpress* debit card will now process transactions incurred during the extension period! The card has been programmed to prioritize the use of an available balance in the prior year and to draw on these funds first.
- ✓ Currently, most clients have a grace period of 90 days to submit claims incurred in the prior plan year. This grace period will remain in place as is. It will not begin following the "two and one half month rule" extension.
- ✓ In order to be effective, the "two and one half month rule" amendment must be in place (signed) prior to the end of the current plan year.

Example #1: An Employer with a cafeteria plan year ending on December 31, 2005, amended the plan document before the end of the plan year to permit an extension period which allows all participants to apply unused benefits or contributions remaining at the end of the plan year to qualified benefits incurred during the grace period immediately following that plan year. The extension period

adopted by the employer ends on the fifteenth day of the third calendar month after the end of the plan year (March 15, 2006 for the plan year ending December 31, 2005). Employee Chris timely elected salary reduction of \$1,000 for a health FSA for the plan year ending December 31, 2005. As of December 31, 2005, Chris has \$200 remaining unused in his health FSA. Chris timely elected salary reduction for a health FSA of \$1,500 for the plan year ending December 31, 2006. During the extension period from January 1 through March 15, 2006, Chris incurs \$300 of unreimbursed eligible medical expenses. The unused \$200 from the plan year ending December 31, 2005 is applied to pay or reimburse \$200 of Chris's \$300 of medical expenses incurred during the grace period. Therefore, as of March 16, 2006, Chris has no unused benefits or contributions remaining for the plan year ending December 31, 2005. The remaining \$100 of medical expenses incurred between January 1 and March 15, 2006 is paid or reimbursed from Chris's health FSA for the plan year ending December 31, 2006. As of March 16, 2006, Chris has \$1,400 remaining in the health FSA for the plan year ending December 31, 2006.

Example #2: Same facts as Example (1), except that Chris incurs \$150 of eligible medical expenses during the extension period (January 1 through March 15, 2006). As of March 16, 2006, Chris has \$50 of unused benefits or contributions remaining for the plan year ending December 31, 2005. The unused \$50 cannot be cashed-out, converted to any other taxable or nontaxable benefit, or used in any other plan year (including the plan year ending December 31, 2006). The unused \$50 is subject to the "use-it-or-lose-it" rule and is "forfeited." As of March 16, 2006, Chris has the entire \$1,500 elected in the health FSA for the plan year ending December 31, 2006.

**PLEASE SHARE THIS INFORMATION WITH
ANYONE ON YOUR STAFF WHO MAY BE
AFFECTED BY THIS INFORMATION.**

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