

ADVISORY BULLETIN

December 2008

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



WINTER 2008/2009

One of the potential hardships suffered by military personnel upon a call to active duty is the forfeiture of unused health FSA balances since medical expenses during this time are generally covered on base.

In response to this, Congress passed the Heroes Earnings Assistance and Relief Tax Act of 2008 ("Heart Act") in June of this year, which amended Internal Revenue Code Section 125, among other sections, to permit cafeteria plan sponsors to make certain qualifying cash distributions ("Qualifying Reservist Distribution") of unused health FSA benefits to certain qualifying military personnel ("Qualified Reservist") without disqualifying the cafeteria plan.

The Internal Revenue Service (IRS) later issued IRS Notice 2008-82 addressing a number of administrative issues raised by the Act.

What is a Qualified Reservist Distribution?

A Qualified Reservist Distribution (QRD) is defined as (i) a cash distribution of all or a portion of the Health FSA balance (ii) made to a Qualified Reservist (iii) within the specified period. The statute indicates that the QRD must be for "all or a portion of the balance in the employee's account."

Practice Pointer: Employer/plan sponsors aren't mandated to allow QRDs; they are optional. However, if employers decide to allow QRDs, employers must amend their cafeteria plans and Health FSAs to allow them. In Notice 2008-82, the IRS allows for a plan to be amended retrospectively, provided the QRD meets all other requirements specified in the Notice. The

amendment must be made by December 31, 2009 and may be retroactively effective for QRDs elected on or after June 18, 2008.

Who is a Qualified Reservist?

A Qualified Reservist is a member of a "reserve component", as defined in section 101 of title 37 of the United States Code who has been called into active duty for no less than 180 days. A "reserve component" includes any of the following: the Army National Guard; U.S. Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve; Air National Guard of the United States; or the Reserve Corps of the Public Health Service.

What is the specified period?

The specified period begins on the date the reservist is called or ordered to duty and ends on the last day that reimbursements could otherwise be made for the plan year that includes the first day of the distribution period.

If we amend our plan to allow QRDs, what administrative issues should we be aware of?

While the Heart Act left a number of issues unresolved, fortunately the IRS released Notice 2008-82 in October to clarify certain key points. Some of the main points that the Notice address are as follows:

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FSA HEART ACT ADVISORY:

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What amount is available as a QRD?

The rule itself indicates that a QRD must be “all or a portion of the *balance in the employee’s account*”.

Notice 2008-82 states that plan sponsors may adopt any of the following approaches in determining the “balance.” The approach adopted should be noted in the plan amendment.

- (1) the entire amount elected for the health FSA for the plan year minus health FSA reimbursements received as of the date of the QRD request;
- (2) the amount contributed to the health FSA as of the date of the QRD request minus health FSA reimbursements received as of the date of the QRD request; or
- (3) some other amount (not exceeding the entire amount elected for the health FSA for the plan year minus reimbursements).

If the cafeteria plan amendment does not indicate how the plan will determine the amount available as a QRD, then the amount available shall be the amount contributed to the health FSA as of the date of the QRD request, minus health FSA reimbursements received as of the date of the QRD request (option 2 above).

It is important to note that, if the plan restricts the QRD amount (as defined in options 2 and 3), the employer must continue to reimburse all eligible expenses incurred prior to the date the QRD is requested -- up to the election amount, reduced by the sum of prior reimbursements and the Qualified Reservist Distribution. Thus, it still is possible to pay out the full election amount.

Taxation of a QRD

Since the Qualified Reservist receives Qualified Reservist Distributions in cash, the Qualified Reservist Distributions should be included in income as wages. Consequently, it should be reported on the W-2 for the year in which the QRD is made, and it is subject to applicable withholding.

Cafeteria Plan QRD Procedures

The cafeteria plan may specify a process for employees to request a QRD. The cafeteria plan may specify how many QRDs may be made with respect to an employee during the same plan year. A plan must permit an employee to submit health FSA claims for medical expenses incurred before the date a QRD is requested and must pay or reimburse substantiated claims for those medical expenses. With respect to medical expenses incurred after the date a QRD is requested, the plan may either:

- (1) permit employees to continue to submit health FSA claims incurred before the end of the health FSA plan year (and grace period, if applicable); or
- (2) terminate an employee’s right to submit claims.

When to request a QRD

Qualified Reservists must request a QRD on or after the call to duty, and before the last day of the plan year (or grace period, if applicable) in which the call or order is received.

PLEASE NOTE: The information above is provided on an informational basis only and is not intended as legal advice. For administrative and legal issues, please consult with your company's legal representative.