

# Flex Plan News

**Flexible Benefit Plan News for Administrators****May 20, 2005**

## **BREAKING NEWS:** **IRS ANNOUNCES NEW “GRACE PERIOD” FOR FSA EXPENDITURES**

In the biggest development of the year for flexible benefit plans, the Treasury Department and the IRS announced yesterday a new rule that will allow flex plans to reimburse participants for claims incurred up to 2-1/2 months after the end of the plan year.

The new rule, issued in *Notice 2005-42*, will serve to reduce the risk of the “Use-It-or-Lose-It” rule for Section 125 plans. The effect of the ruling is to give participants up to 14-1/2 months to incur eligible expenses and use amounts contributed to an FSA for a particular plan year. Of course, under the previous rule, all reimbursable expenses had to be incurred within the 12-month (or other time-specified) plan year.

Notable elements of the new rule:

- (1) An employer is permitted to adopt this rule, but there is no requirement to do so. If an employer chooses to adopt the new rule, it must be adopted for all participants in the flex plan.
- (2) An employer may adopt the 2-1/2 month “grace period” rule for its current plan year by amending its plan document before the end of the plan year. This deadline for amendment effectively precludes retroactive application of the rule to 2004 for plans based on the calendar year.
- (3) A grace period of less than 2-1/2 months would also be permissible at the option of the employer.

- (4) Amounts set aside for one purpose, e.g. salary reduction credited to a Health FSA, may be used only for the same purpose during the grace period. For example, unused Health FSA amounts may not be shifted to a Dependent Care FSA, cashed out, or otherwise.

The Treasury Department press release, including a link to the official Notice, is at:

<http://www.treas.gov/press/releases/js2456.htm>

### **Example**

- An employer with a flex plan ending 12/31/05 amends its plan document before the end of the year to permit a 2-1/2 month grace period during which participants can spend unused contributions remaining in their FSA accounts. The grace period will end on March 15, 2006.
- Susan elected \$1,000 in pretax salary reduction for the plan year ending 12/31/05. As of 12/31/05, Susan has \$200 remaining unused in her Health FSA. Further, Susan elected \$1,500 for the plan year ending 12/31/06. During the grace period between 1/1/06 and 3/15/06, Susan incurs \$300 in unreimbursed, eligible medical expenses. The unused \$200 from the plan ending 12/31/05 is reimbursed from 2005 plan contributions. The remaining \$100 is reimbursed from 2006 plan contributions. After reimbursement, Susan has fully exhausted her 2005 FSA, and has \$1,400 remaining in her 2006 FSA.
- Any balance remaining in an employee’s 2005 FSA as of 3/15/06 would be forfeited, pursuant to the “Use-It-or-Lose-It” rule. (This would not include expenses already incurred but not reimbursed.)

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