



FSAs More Attractive With New Extended Deadline

Workers who have been reluctant to contribute to flexible spending accounts (FSAs) will find them more appealing, thanks to a new ruling by the IRS.

Effective May 18, workers can take up to 2-1/2 months following the end of their plan year to incur expenses against their FSA accounts for medical, dental, and vision care. Even day care expenses can be included in this new deadline. In essence, they can carry over funds into the next plan year.

Historically, IRC Section 125 Cafeteria Plans have forbidden postponing the recognition of earned income. In other words, participants could not use non-taxed compensation from one plan year to pay for expenses they incurred in a subsequent plan year. And, the dreaded “use it or lose it” constraint was unappealing to many workers because it required careful planning, awareness of account balances and deadlines, plus possible loss of their money.

Now, employees can buy 12 months of health care coverage and receive more than 14 months of coverage. This extra breathing room for miscalculation of annual election amounts and submitting claims should avoid forfeiting of unused benefit funds.

[Click here to read the IRS Notice 2005-42.](#)

Advantages for employers

More workers will likely choose to enroll in the employer’s FSA plan, which means more savings for both employers and their employees.

Savings include:

- Employer FICA taxes
- Employee federal taxes
- Employee state and local taxes (where applicable)

With the cost of health care skyrocketing, even employers who have never considered offering FSAs will be more open to implementing an FSA plan. And, from a public relations standpoint, offering flexible spending accounts can improve employee morale and increase employee satisfaction, resulting in less turnover.

Improve Plan Participation

During the course of the plan year, employees find themselves in different situations: The participants that elected too much at the beginning of the plan year, those that didn’t elect enough, and employees who did not join the plan. This clarification by the IRS addresses these predicaments and will improve plan participation.

The employee that elected too much can begin to relax. With an extra 2-1/2 months to spend their money, the expenses they would have incurred in the next plan year can fall into the current year. Next year’s election may be lower, but they will continue to participate instead of dropping out because of a bad experience with losing money.

How about the employee that has already run out of money? He will elect more in future plan years because his risk of loss is reduced. That conservative edge will be blurred with the bonus coverage period.

As for the employee that didn’t choose to participant – all the buzz and reduced risk of loss will entice his participation into this terrific employer-sponsored benefit.

Employers may even think about implementing a new, concurrent cafeteria plan that starts now and runs until the end of their present plan year. It would be a great benefit for those

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employees wanting to opt for additional medical, dental, and vision coverage or to make a first-time election into the plan.

Implementing the change

- Employees are eligible for the extension only if employers amend their plan documents by the last day of their current plan year.
- Employers and plan sponsors cannot extend the coverage deadline beyond 2-1/2 months following the end of the plan year but can establish a shorter period.
- Just one word of caution. Yet to be clarified is how the new ruling will affect HIPAA's portability requirements, whether the carry-over requirements apply to COBRA coverage, and how it affects DCAP W-2 benefit reporting obligations.

Educating Workers

The IRS calls the extension a "grace period," but it will be imperative that plan administrators and employers drive home the fact that workers can still lose their account balance at the end of the extended coverage period, if they do not incur and submit any claims. Unused funds can not be returned to employees following this new "grace period."

In addition, employees need education on how to coordinate their 2005 and 2006 FSA contributions for maximum benefit.

In Summary

The IRS has made a significant improvement to flex plans that will make them more attractive to employers and employees. It is a simple fix and it eases the liability for employees without adding substantial liability for the employer.

That's not to say there won't be any bumps during implementation. Coordinating across benefit years, updating software platforms to handle the added complexity, and the lack of clarification in the ruling will cause some headaches.

The change can mean costly charges associated with training and extra administration efforts. But rest assured, this new plan option is no secret. Employees are going to demand that employers amend their plan documents to embrace this new opportunity.

It's a non-partisan decision - everyone votes for the extra time to spend their unused FSA money. ■

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