JONES WALKER

E*ZINES
June 2005

Employee Benefits, ERISA & Executive Compensation
www.joneswalker.com
benefits@joneswalker.com

IRS BENDS ON USE-IT-OR-LOSE-IT RULE FOR FLEXIBLE SPENDING ACCOUNTS

By: Timothy P. Brechtel
Susan K. Chambers

Current Use-It-or-Lose-It Rule

Flexible spending accounts (FSAs) enable employees to set aside salary on a pre-tax basis to pay for unreimbursed medical or child care expenses. Employees have an incentive to be conservative when estimating the amount of expenses they want to have reimbursed from an FSA because of the "use-it-or-lose-it" rule. Under this rule, if the employee does not incur qualifying expenses by the last day of the plan year at least equal to the amount contributed to the account for the plan year, the unused amount must be forfeited. FSAs are typically funded solely with employee dollars, and the dollars forfeited would otherwise have been paid to the employee as salary.

Notice 2005-42

On May 18, 2005, the IRS issued Notice 2005-42, in which it stated that employees may be given a grace period of up to two months and fifteen days (until March 15 for a calendar year plan) during which they can incur additional qualifying expenses and be reimbursed from FSA funds contributed in the prior year. This does not eliminate the use-it-or-lose-it rule, but does allow additional time to incur expenses and may reduce (or at least delay) the need to rush to the dentist, optometrist or drug store in late December to spend down FSA funds.

The change is not mandatory, and there are several requirements that must be followed in order to take advantage of the new, more lenient rule:

- The FSA plan document must be amended before the end of 2005, if an employer wishes to grant the grace period for 2005 contributions.
- If granted, the grace period must be made available to all participants (including those on COBRA).
- The grace period cannot extend beyond the 15th day of the 3rd month after the end of the plan year (though it can be shorter).

Several issues should be considered by plan sponsors in connection with this change. If FSA claims are handled by a third party administrator (TPA), the employer should consult with the TPA regarding whether it will accommodate a grace period. Also, plans typically have run-out periods during which expenses incurred in the prior year can be submitted for reimbursement (*e.g.* employees may have until March 30 to submit claims for expenses incurred in the prior year). If the grace period is adopted, the claims run-out period may need to be extended. Finally, if the employer relies on forfeitures to offset plan expenses, a grace period may reduce the amount of forfeitures, resulting in more costs being paid by the employer.

ADMIRALTY & MARITIME
ANTITRUST & TRADE REGULATION
APPELLATE LITIGATION
AVIATION
BANKING
BANKRUPTCY, RESTRUCTURING & CREDITORS-DEBTORS RIGHTS
BUSINESS & COMMERCIAL LITIGATION
CLASS ACTION DEFENSE
COMMERCIAL LENDING & FINANCE
CONSTRUCTION
CORPORATE & SECURITIES
EMPLOYEE BENEFITS, ERISA, & EXECUTIVE COMPENSATION
ENERGY
ENVIRONMENTAL & TOXIC TORTS
GAMING
GOVERNMENT RELATIONS
HEALTH CARE
INSURANCE & FINANCIAL SERVICES
INTELLECTUAL PROPERTY
INTERNATIONAL
LABOR RELATIONS & EMPLOYMENT
MERGERS & ACQUISITIONS
PRODUCTS LIABILITY
PROFESSIONAL LIABILITY
PROJECT DEVELOPMENT & FINANCE
PUBLIC FINANCE
REAL ESTATE: LAND USE, DEVELOPMENT & FINANCE
TAX (INTERNATIONAL, FEDERAL AND STATE)
TELECOMMUNICATIONS & UTILITIES
TRUSTS, ESTATES & PERSONAL PLANNING
VENTURE CAPITAL & EMERGING COMPANIES
WHITE COLLAR CRIME

Action Item
Although employers with calendar year plans have until the end of 2005 to amend their FSA plans, they should decide whether they want to allow the grace period prior to annual open enrollment, so that employees can be educated about the changes prior to making their elections for 2006 and so that changes can be made to internal or TPA procedures for handling reimbursement claims.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. In addition, the authors of this summary will be happy to field your questions, at the following telephone numbers:

Timothy P. Brechtel	504-582-8236
Susan K. Chambers	504-582-8394

Employee Benefits, ERISA & Executive Compensation

ALTON E. BAYARD
JOHN C. BLACKMAN
TIMOTHY P. BRECHTEL
SUSAN K. CHAMBERS[1]
EDWARD F. MARTIN
MARGARET F. MURPHY
RUDOLPH R. RAMELLI
KELLY C. SIMONEAUX

[1] Also admitted in W. Virginia

To subscribe to other E*Zines, visit www.joneswalker.com/news/ezine.asp