

*IRS Permits
Extended
Claims Periods
for Flexible
Spending
Account Plans*

Pursuant to Notice 2005-42 recently issued by the Internal Revenue Service, flexible spending account plans may now provide for a grace period of up to 2½ months during which participants may claim unused funds remaining in their health care or dependent care reimbursement accounts as of the end of a plan year.

Prior to Notice 2005-42, any funds remaining in a participant's flexible spending account at the end of the plan year (and not claimed by the end of any run-out period provided for under the plan) must be forfeited. This is referred to as the "use-it-or-lose-it" rule. Under the new IRS Notice, the use-it-or-lose-it period may be extended until March 15th of the following year (or for 2 ½ months for non-calendar year plans) and participants may use expenses incurred during the grace period to claim funds remaining in the participant's account from the prior year.

The following example illustrates how the grace period works:

A flexible spending account plan using a calendar year plan year adopts the new grace period provision for the 2005 (and future) plan years. A participant who elected to contribute

\$3,000 to his health care account in 2005 has \$1,000 of unused funds in his account as of December 31, 2005. Under the new grace period provision, the participant may use eligible health care expenses incurred after December 31, 2005 and before March 15, 2006, to claim reimbursement of the \$1,000 of unused funds.

A plan adopting the new grace period must apply it to all participants in the plan. In addition, the plan may not permit unused amounts to be cashed out or converted to any other type of benefit. As under the current rules, unused amounts may only be used to pay or reimburse expenses with respect to the same type of benefit (thus, for example, unused amounts in a health care account may not be used to reimburse dependent care expenses and vice-versa).

As under current rules, employers may still provide for a run-out period after the grace period, during which participants may file claims for reimbursement of expenses incurred before the end of the grace period.

Employers may adopt the new grace period for their flex plans for the current plan year, provided they adopt an amendment to the plan no later than the end of the year.

For assistance in amending your flexible benefit plans as permitted under the new IRS Notice, or for any questions you may have regarding flexible benefit plans, please feel free to contact:

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