

## **ErisaALERT**

October, 2008

### **Heroes Earnings Assistance and Relief Tax Act of 2008**

(impact on health care flexible spending accounts)

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) was passed in June, 2008. The Act contained provisions impacting qualified plans as well as health plans, and specifically health care flexible spending accounts (FSA). On September 30, 2008 the IRS issued Notice 2008-82 which provided guidance relating to the cafeteria plan provisions. The notice can be found at <http://www.ustreas.gov/press/releases/reports/notice%20200882.pdf>. This ErisaALERT will address the cafeteria plan guidance only. A forthcoming ErisaALERT will address the qualified plan provisions.

#### **Cafeteria plan provisions**

HEART added section 125(h) to the Internal Revenue Code (the Code) which permits cafeteria plans to provide qualified reservist distributions (QRD) to an employee of all or a portion of the balance of the employee's unused amounts in the health FSA.

#### **Bottom line:**

- A cafeteria plan is not required to provide for a QRD
- A QRD cannot be made before the cafeteria plan is amended to provide for a QRD from a health FSA. However, a plan may be amended retroactively to permit QRDs requested on or before December 31, 2009 provided that the QRD satisfies the requirements of the notice. The retroactive amendment must be made by December 31, 2009 and be retroactive to the first day a QRD was paid from the plan but not before June 18, 2008.
- An employee cannot request a QRD with respect to a plan year after the last day of the plan year (or grace period, if applicable) during which the order or call to active duty occurred.

#### **What is a QRD?**

A QRD is a distribution to an individual of all or a portion of the balance in the employee's health FSA if:

1. The individual is a member of a reserve component ordered or called to active duty for a period of 180 days or more or for an indefinite period and

2. The request for distribution is made during the period beginning with the order or call to active duty and ending on the last day of the plan year (or grace period, if applicable) that includes the date of the order or call to active duty.

## **The Administrative Details**

### **The basic administrative requirements**

A QRD may not be made based on an order or call to active duty of any individual other than the employee, including the spouse of the employee.

An individual called to active duty before June 18, 2008 is eligible for a QRD if the individual's period of active duty continues after June 18, 2008 and meets the duration requirement (180 days).

A QRD may only be made with respect to an employee's health FSA balance in existence on or after June 18, 2008. A QRD may not be made with respect to amounts forfeited on or before June 18, 2008; attributable to a prior plan year (including a plan year ending on or before June 18, 2008 or attributable to non-health FSAs).

If you decide to permit QRDs, the amendment should indicate how the plan will determine an employee's health FSA balance for purposes of making the QRD. If the amendment doesn't indicate how the plan will determine the amount available for a QRD, the default provision will 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 request.

### **The administrative procedures**

The cafeteria plan may specify a process for employees to request a QRD including how many QRDs may be made available to an employee during the same 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, a plan may either 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 terminate an employee's right to submit claims.

The employer must first receive a copy of the order or call to active duty and may rely on order to determine the period that the employee has been ordered to serve. If the order is for 180 days or more or is indefinite, the employee is eligible for a QRD. The employee's eligibility is not affected if the actual period of duty is less than 180 days or is otherwise changed.

If the order is less than 180 days, a QRD is not allowed. Subsequent orders that increase the period of active duty to 180 or more days will qualify the employee for a QRD.

An employee must request a QRD on or after the date of the order or call to active duty and before the last day of the plan year (or grace period, if applicable) during which the call to duty occurred. An employer must pay the QRD to the employee within a reasonable period of time but not more than 60 days after the request for a QRD has been made. A QRD may not be made with respect to a plan year ending before the order or call to active duty. A QRD may only be made on or after the effective date of the amendment to the plan taking into account the transition rule noted previously.

**Impact on nondiscrimination testing**

QRD amounts are disregarded for purposes of cafeteria plan nondiscrimination testing.

**Tax Implications**

A QRD is included in the gross income and wages of the employee and is subject to employment taxes. The employer must report the QRD as wages on the employee's W-2 for the year in which the QRD is paid to the employee. The amount reported as wages is reduced by any amount in the health FSA representing after tax contributions (e.g., COBRA continuation premiums).

**Note:** This material is for the sole purpose of providing general information and does not under any circumstances constitute legal advice and should not be used as a substitute for legal advice. You should seek the advice of counsel when applying the requirements to your plans. For more information on this ErisaALERT, contact us by phone at 610-524-5351 and ask for Mary Andersen or 973-994-7539 and ask for Theresa Borzelli.

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