

FSA GRACE PERIOD: Q & A FOR EMPLOYER GROUPS

What is the Grace Period allowed by IRS Notice 2005-42?

Under the previous IRS rules, participants in an FSA plan were required to “use it or lose it” within a plan year. Since most plans utilize a calendar year, this generally created a rush period at year-end, where participants would either schedule incidental medical care, or purchase items such as eyeglasses and hearing aids that might not have been covered under their normal benefits.

The Grace Period is an extension of the time allowed to incur eligible charges. The maximum extension allowed is 2 ½ months. In simple terms, adoption of a 2 ½ month grace period allows an employee 14 ½ months in which to accumulate expenses payable from 12 months of contributions.

How is this different from the “run-out” period?

A “run-out” period is simply the time period allowed at the end of the plan year in which to submit eligible claims. For example, a calendar year plan with a 60-day run out requires that claims incurred prior to December 31 be submitted no later than March 1 of the following year.

Is the Plan Sponsor required to add a Grace Period to an existing FSA plan?

No. This is an optional benefit. The Plan Sponsor may choose to add a Grace Period or not. The Plan Sponsor may also choose the length of the Grace Period. It is not necessary to allow the full 2-½ months allowed under the new regulations.

Does the Grace Period apply to medical reimbursement only?

No. There is no limitation on applying the Grace Period to all aspects of the FSA plan. However, the IRS has published no rules or opinions on the tax implications to DCAP plans to date. Activa Benefits recommends applying the Grace Period to medical reimbursement only at this time.

Will other plan modifications be required if the plan adopts a Grace Period?

The only aspect of the FSA plan that may need to be changed along with the addition of a Grace Period would be the run-out provision. If a plan adds a 2-½ month Grace Period, but only allows a 60-day run-out from the end of the plan year, employees could not fully utilize the grace period. Activa Benefits recommends that Plan Sponsors who wish to incorporate a 2 ½ month Grace Period also change their run-out period to 90 days. For calendar year plans, this would allow participants to incur expenses up until March 15, and those claims would need to be filed by March 31.

In order to have the Grace Period apply to the 2005 calendar year, Activa needs a request for amendment from the Plan no later than October 1, 2005. For those plans that operate on a plan year, the request should be made no later than 90 days before the end of the plan year, to allow time for preparation of the documents and information to participants on how the changes will work.

For additional information, please contact Activa Benefit Services at 616-588-5340 or 877-827-1414.