

BENEFITS ALERT 2008-03

To All FBMC Clients

Date October 1, 2008

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Re **Revenue Notice 2008-82**

Purpose: This revenue notice provides additional guidance on Qualified Reservist Distributions (QRDs) from health FSAs and includes a transition rule allowing plans to be retroactively amended for QRDs made before 1/1/2010.

The Treasury and IRS just issued additional guidance on Section 114 of the Heroes Earnings Assistance and Relief (HEART) Act of 2008. The Act is designed to help military personnel called to active duty who may otherwise forfeit dollars set aside in a medical flexible spending arrangement (MFSA). According to the Act, an employer (plan sponsor) may make a **cash distribution** of unused MFSA benefits to eligible reservists without disqualifying its cafeteria plan(s). In the most recent Quarterly Review and Benefits Alert 2008-02, we detailed the features, including the basic requirements; however, several areas of the law were unclear. This new guidance is very helpful in answering some of those troubling questions and provides a clear basis for adopting the Act's provisions.

As you may recall, the **cash distribution** is referred to within the act as a qualified reservist distribution (QRD). To be deemed a qualified reservist distribution, the individual must be a "reservist" and the deployment must be a minimum of 180 days or indefinite – this was pretty straight forward. The Act went on to tell us that the distribution must be for all or a portion of the balance in the employee's MFSA account without explaining what was meant by a **portion of the balance**; further that the distribution must be requested between specified dates which were confusing when one started to use scenarios to determine how the deployment and the request might work.

Using the same format we used previously, we will now add the new guidance.

The individual must be a "reservist" as defined in 37 U.S.C. § 101 which means the individual "must be a member of":

- Army National Guard of US
- Army Reserve
- Navy Reserve
- Marine Corps Reserve
- Air National Guard of US
- Air Force Reserve
- Coast Guard Reserve
- Reserve Corps of the Public Health Service

The reservist must be called to active duty for a minimum of 180 days or an indefinite period.

The new guidance clarifies the mechanics of how this will work, what documentation is needed and what happens when the order is changed:

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- a. The employer may rely on the call or order to confirm the 180 day or indefinite time period.
- b. The employer must have the **call** or **order** in hand before the distribution can be approved.
- c. If a call or order is less than 180 days, a QRD must not be approved; if the call or order is subsequently increased and the total period of active service is 180 days or more, a QRD may then be approved.
- d. If a QRD is approved and later the call or order is changed to less than 180 days, the change does **not** affect the previous approval.

The distribution must be for all or a portion of the balance in the employee's medical FSA account.

The new guidance clarifies that the plan may decide the amount available as a qualified distribution:

- a. The distribution may be the entire annualized amount (also referred to by our clients as the annual election or the annual goal) for the MFSA less reimbursements received;
- b. The distribution may be the amount contributed by the reservist less reimbursements received; or
- c. The distribution may be another amount determined by the employer less any reimbursements received (as long as the "other" amount does not exceed the original annualized amount).

Note: If the plan document does not specify the manner to determine the amount available, then the default is method "b" above.

The distribution must be requested between specified dates: the date the reservist is ordered or called and the last day the reimbursement could be made for the plan.

The new guidance clarifies what requests can be authorized, when the request must be made and when the distribution must be made:

- a. An individual called to active duty before 6/18/2008 is eligible **as long as** active duty continues beyond 6/18/2008.
- b. The request for distribution **must be made** during the period beginning with the order or call and ending on the last day of the plan year. If the plan includes a grace period (don't confuse this with the runout period) then the last day of the plan year means the last day of the grace period.
- c. The request for distribution must be for the plan year in which the call or order occurred; not the previous plan year or the next plan year.
- d. The distribution to the reservist must be made within a reasonable time, not to exceed 60 days after the request for a distribution has been made.

Note: A very important date to keep in mind is 6/18/2008. Although a reservist can be called to active duty before this time, and still request and receive a distribution (item "a"), the active duty must continue beyond 6/18/2008 for the distribution to be eligible. A distribution cannot be requested for any plan years ending prior to 6/18/2008 or on any amounts forfeited prior to 6/18/2008.

Tax treatment of the distribution;
the new guidance clarifies:

A qualified reservist distribution (QRD) is included in the gross income and wages of the employee and is subject to employment taxes. The distribution must be reported as wages on the employee's Form W-2. It is reportable for the year in which the distribution is paid.

Plan Amendments;
the new guidance provides a transition rule for QRDs made before 1/1/2010:

Generally amendments to cafeteria plans and MFSA's may only be effective prospectively from the date of the plan amendment. However, this Revenue Ruling provides that an amendment made by 12/31/2009 may be effective retroactively to the date of the first QRD paid under the plan. This means if you want to sit back this year and wait to amend you plan until you see if you will actually receive a request for a distribution, you may do so up until 12/31/2009. After that you need a plan amendment in place.

If you have any questions, please contact tneely@fbmc.com.

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