

Benefits Alert 2005-6

To	All Clients & Friends of FBMC	Date	9/8/2005
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Re	Revenue Notice 2005-61		

As promised by Harry Beker and Beth Purcell at the recent ECFC conference, the IRS has promptly issued further clarification on the impact of the new Grace period on W-2 reporting requirements.

On September 7, 2005, the IRS issued Internal **Revenue Notice 2005-61** to clarify the Form W-2 reporting requirements when an employer has amended a cafeteria plan document to provide the new Grace period for Dependent Care Flexible Spending Arrangements (DFSAs).

As you know, the amount that is required to be reported on Form W-2 is the total amount of cash reimbursement provided to an employee under a qualified dependent care assistance program. Where the employer does not know the actual amount at the time the W-2 is prepared, a reasonable estimate of the total amount is permitted to be reported on Form W-2.

Revenue Notice 89-111 provided a safe harbor that clients and the industry have relied upon for years for a DFSA under a Cafeteria Plan – the amount electively contributed by the employee plus any employer match constitutes a reasonable estimate.

The IRS initially stated informally that the safe harbor could not be applied if an employer adopted the new Grace period for DFSA programs. Notice 2005-61 reverses the informal opinion, as referenced below:

“An employer that amends its cafeteria plan to provide a grace period for dependent care assistance may continue to rely on Notice 89-111, by reporting in Box 10 of Form W-2 the salary reduction amount elected by the employee for the year for dependent care assistance (plus any employer matching contributions attributable thereto).”

Caution: Although the Notice provides relief for Employer reporting, what the employee is required to report on Form 2441 for each tax year is not addressed by the Notice.

The IRS has stated in recent teleconferences that any dependent care contributions remaining unused at the end of the 2005 plan year that were used to reimburse expenses incurred during the grace period in 2006 (and similarly for subsequent years) would reduce the maximum contribution allowed for the 2006 tax year and could result in imputed income if the employee miscalculated and exceeded the \$5,000 cap. Clearly an overhaul of Form 2441 is in order if the Notice was meant to apply to both employer and employee reporting.

Further clarification will likely be forthcoming and we will update you promptly. We know that

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some of you were very interested in extending the Grace period for DFSA. Although this Notice removes a major obstacle it still raises concerns for us because it does not address employee reporting.

For additional questions or inquiries, please contact your Account Manager or the undersigned. If you are interested in offering the grace period for your DFSA program, please notify your Account Manager as quickly as possible.