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September 09, 2005 Issue # 13

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Editor's Note

In an effort to keep you informed of regulation issues and new developments, we will be sending quarterly issues of our newsletter, **Benefits Briefing**. If there are HR contacts at your company who would benefit from this, please give us their names and email addresses, and we will add them to the distribution list.

IRS Clears Way for Extending "Grace Period" to Dependent Care Reimbursement Accounts

On September 7, 2005 the IRS clarified Form W-2 reporting requirements for Dependent Care Assistance Programs when an employer amends a Cafeteria Plan to take advantage of the new "Grace Period" provisions. IRS Notice 2005-61 provides that "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 of dependent care assistance (plus any employer matching contributions attributable thereto)." The full text of this notice may be found at <http://www.irs.gov/pub/irs-drop/n-05-61.pdf>

Prior to this notice, many attorneys and consultants suggested that extending the grace period to Dependent Care Reimbursement Accounts would cause reporting problems with employees being able to receive in excess of the statutory \$5,000 maximum benefit in a calendar year. Notice 89-11 states that for a salary reduction arrangement under a Section 125 cafeteria plan, the amount electively contributed by an employee for the year for dependent care assistance may be reported on Form W-2 as a reasonable

estimate of the benefit received.

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What Must a Plan Sponsor Do To Take Advantage of the **Grace Period**?

Our June 2005 *Benefits Briefing* {http://www.tri-starsystems.com/NL_06_2005.htm} was dedicated entirely to the **grace period**, including a section on what Plan Sponsors need to do and a discussion of various options for processing claims incurred during the **grace period**. We have developed the following questionnaire to assist our clients and prospects

FSA Grace Period Checklist

Will you be amending your plan to take advantage of the Grace Period for your HCRA / DCRA / Both / Neither?

1. If amending your plan, will you:
 - Take advantage of the full 75 days? Yes ___ / No ___
 - Limit the dollar amount eligible? Yes ___ / No ___
 - Extend the run out period for filling claims? Yes ___ / No ___
 - If extending the run out period, to what date? ___/___/_____
2. When will you be communicating the changes to your employees/associates?
3. Are you contemplating the addition of an HSA eligible medical plan for the upcoming plan year? Yes ___ / No ___
4. If yes to question 3, are you aware that participants in an FSA that includes the Grace Period will not be eligible for participation in the HSA until the 1st day of the month following the end of the Grace Period? Yes ___ / No ___
5. If yes to question 3, have you considered offering Limited Purpose HCRA for the upcoming plan year? Yes ___ / No ___ / N/A ___

Tri-Star is prepared to assist you in preparing a plan amendment and communications to your employees.

You may also want to consult with your attorneys or consultants.

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Tri-Star Proposed Grace Period Administration Process

In our June 2005 **Benefits Briefing** we discussed some of the administration issues we anticipated in adopting the **grace period**. We are recommending the following approach to processing claims incurred during the grace period. We believe it will give plan participants the greatest advantage while minimizing the service questions and calls.

If a participant has an account for both the old and new plan years, during the grace period and claim run-out period we will apply claims submitted to the plan year in which they were incurred. Then, at the end of the claim run-out period (now possibly extended to 5 and ½ months after the end of the plan year), look back to see if any balance remains in the prior plan year and reprocess the claims to make an “adjustment” for eligible grace period claims back to the prior plan year balance for the lesser of the prior year balance or the **grace period** claims submitted. If a participant has an account in only the old plan year we will process grace period claims in the old plan year.

If our employers amend their plans taking this approach, we do not anticipate increasing our fees to process grace period claims. We are still awaiting formal guidance from the IRS, however, we spoke directly with Harry Beker of the IRS, and he indicated that he saw no problems with this approach.

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Notes from the Employers Council on Flexible Compensation (ECFC) Administrators’ Symposium

The 18th Annual ECFC Administrators Symposium was held in Reno, NV from August 17–19, 2005. Benefit experts including ECFC Attorneys and IRS Officials spoke and interacted with over 150 Flexible Benefit Professionals from around the country. Topics included Debit Card substantiation, interaction between FSAs, HRAs, and HSAs, technology improvements, pending IRS guidance and various Flex legal and administrative issues.

Harry Beker, IRS Branch Chief, Health and Welfare Division indicated that the 2005/2006 IRS business plan included issuing guidance on the following topics:

- Employer HSA Contribution Regulations (published August 25, 2005)
- Grace Period and Dependent Care Reimbursement Account W-2 reporting requirements (issued September 7, 2005)
- Guidance on Debit Card substantiation in FSA Administration (expected “soon”)
- FSA Grace Period effects on HSA eligibility (expected “soon”)
- Update of Section 125 Regulations (expected in the Spring of 2006)

The conference also included an animated discussion on Debit Card substantiation and adjudication. The majority of administrators indicated they were using a conservative approach on substantiation of FSA expenses paid using a debit card in compliance with current IRS guidelines. A few administrators were taking a more liberal approach hoping for future relaxation of the IRS position. Those more liberal administrators appeared to be motivated by reduction of their costs and efforts.

Hopefully the IRS will issue the promised guidance soon. We will bring that information to you as soon as it becomes available.

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IRS Publication Links

With tax season upon us we wanted to provide you with some handy links to IRS Publications that may help you and your employees. We hope they are helpful to you.

[IRS Publication 502 \(Health Care\)](#)

[IRS Publication 503 \(Dependent Care\)](#)

[IRS Publication 969 \(HSAs and Other Tax-Favored Health Plans\)](#)

[IRS Publication 968 \(Adoption\)](#)

[Other IRS Publications](#)

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