



## IRS Issues Guidance on FSA Distributions under the Heroes Earnings Assistance and Relief Tax Act

*The Heroes Earnings Assistance and Relief Tax Act (HEART), which was enacted June 17, 2008, provides tax breaks and incentives for military personnel. One provision permits distributions from health flexible spending accounts to certain employee-reservists called to active duty. The IRS has issued guidance on this provision.*

### Background

HEART amended Internal Revenue Code Section 125 to allow employers to provide “qualified reservist distributions” (QRDs) from health flexible spending accounts (FSAs) to employee-reservists who are called to active duty for 180 or more days, or for an indefinite period of time. (See our June 18, 2008 [For Your Information](#).) A QRD is a distribution of all or a portion of the balance in an employee’s account that is requested during the period that begins on the date of the call up and ends on the last date that the reimbursement could otherwise be made under the health FSA for the plan year. These distributions may be made after June 17, 2008.

The IRS has issued [Notice 2008-82](#), which provides important guidance for plan sponsors who wish to add this feature to their FSAs.

### Notice 2008-82

In the notice, the IRS addresses the following issues.

**Plan Amendments.** The notice states that a QRD provision is voluntary and a plan must be amended to include it. It also clarifies that a dependent care FSA cannot include a QRD.

Further, the notice specifies that a QRD may not be made until the plan is amended to include the provision. Importantly, however, the IRS provides transition relief allowing a plan amendment to be made retroactive to June 18, 2008 as long as it is made by December 31, 2009.

**Eligibility.** To be eligible for a QRD, the employee-reservist must be called up for at least 180 days, or an indefinite period of time. The employee’s eligibility is not affected if the period of active duty ends up being less than 180 days or is otherwise changed.

**BUCK COMMENT.** *While the call must be for at least 180 days, the guidance clarifies that the initial call and subsequent calls can be combined to meet the 180 days. For example, an employee whose initial call to active duty is for 120 days, but is subsequently extended for an additional 60 days, is eligible for a QRD.*

Further, the QRD must be made available uniformly to all FSA participants, but can only be made based on an employee's call up, and not for any other individual, including the spouse of the employee. In addition, QRD amounts are not taken into account for cafeteria plan nondiscrimination testing.

**Distributions.** An employee-reservist must request the QRD on or after the date of the call up order, but no later than the last day of the FSA plan year (or grace period, if applicable) that includes the date of the order. The notice specifies that the employer must receive a copy of the order or call to service before making the distribution. The QRD must be paid within a reasonable time, but not more than sixty days after the QRD request is made.

The notice allows the employer flexibility in determining the plan balance to be distributed, but specifies that the plan must indicate the method chosen. The following are listed as acceptable methods –

- the entire amount elected for the plan year minus any FSA reimbursements received as of the date of the QRD request
- the amount contributed to the FSA as of the date of the QRD request, minus any FSA reimbursements received as of the date of the QRD request
- any other method which does not exceed the entire amount elected for the plan year minus reimbursements.

The plan must allow employees to submit health FSA claims for expenses incurred before the date the QRD is requested. However, for expenses incurred after that date, the plan may either permit employees to continue to submit health FSA claims incurred before the end of the plan year (or grace period, if applicable), or terminate an employee's right to submit claims.

**BUCK COMMENT.** *Allowing employees to continue to submit health FSA claims after they submit the QRD request will reduce their amount of taxable income.*

**Taxation of QRDs.** The notice confirms that a QRD is included in the gross income of the employee and is subject to employment taxes.

## Conclusion

Notice 2008-82 provides very practical and flexible guidance for employers who want to add this QRD provision to their FSA programs. While employers are not required to include this provision in their FSAs, it could be a valuable benefit for employees called to service who would otherwise forfeit unused FSA funds. Buck's consultants would be pleased to discuss this new guidance with you, as well as the other provisions included in HEART.

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*This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.*