

IRS ISSUES GUIDANCE ON QUALIFIED RESERVISTS DISTRIBUTIONS

You may remember hearing about the Heroes Earnings Assistance and Relief Tax Act (HEART Act) of 2008 which expanded certain benefits for members of the Military and Reserve Corps. Section 114 of the HEART Act amended Internal Revenue Code (Code) Section 125 to provide a special rule allowing for distributions of unused amounts in the health Flexible Spending Account (health FSA) to a reservist-employee ordered or called to active duty. This week, the IRS issued Notice 2008-82 providing the first guidance on these Qualified Reservists Distributions.

QUALIFIED RESERVIST DISTRIBUTION

Under the general rule, a health FSA may only reimburse qualified medical expense under Code Section 213 and may not provide a cash-out. Qualified Reservist Distributions (QRDs) are an exception to this general rule, providing for a cash distribution of all, or a portion of the balance in an eligible employee's health FSA.

OPTIONAL PROVISION

QRDs are not mandatory. Employers may choose whether to offer these distributions. Should QRDs be offered under the health FSA, the distribution must be available to all similarly situated individuals.

AMENDMENT REQUIRED

In order to offer a QRD, the plan documents must be amended. The proposed cafeteria plan regulations require that amendments are made on a prospective basis. However, in the case of the QRD, the IRS provides a limited exception to the prospective amendment rule, as discussed below.

LIMITED EXCEPTION TO THE AMENDMENT REQUIREMENT – SPECIAL TRANSITION RULE

The IRS provides a special transition rule allowing the plan sponsor to retroactively amend the plan to permit QRDs requested between June 18, 2008 and December 31, 2009, provided the distribution requests satisfy all other requirements. The retroactive amendment must be in place by December 31, 2009, and be effective retroactive to the date of the first QRD was paid under the plan (but not prior to June 18, 2008).

This means plans opting to provide QRDs without a current plan amendment in place should retroactively amend their plan back to the date of the first QRD by December 31, 2009. After December 31, 2009, any QRD amendments must be made on a prospective basis.

ELIGIBILITY

In order to be eligible for a QRD:

1. The plan must provide for a QRD;
2. The individual requesting the distribution is a member of a reserve component¹ ordered or called to active duty for a period of 180 days or more, or an indefinite period; and
3. The request for the distribution is made during the period beginning with the order or call to active duty and ending on the last day of the plan year (or grace period if applicable) that includes the date of the order or call.

An individual who was called to duty prior to June 18, 2008 is eligible for a QRD if the period of active duty continues after June 18, 2008, meets the duration requirements (180 days or more) and is within the applicable plan year (and grace period). Only employees are eligible for the QRD. A distribution from the health FSA may not be made based on a spouse or dependent call or order to active duty.

REQUESTING THE QRD

An employee may request a QRD on or after the date the employee received the order or call to active duty and before the last day of the plan year (or grace period) in which the order/call occurred.

The employer must receive a copy of the order or call from the employee requesting the distribution. The employer may rely upon the order/call in determining the length of time the individual will be on active duty. If the order specifies a period of 180 days or more, or is indefinite in the length, the individual is eligible for the QRD. This is regardless of whether the actual period of duty is less than the 180 days or otherwise changed.

If the specified period is less than 180 days, then no QRD is permitted. However subsequent calls to order that extend the total period to 180 days or more will qualify for the QRD. For example an initial order of 120 days does not qualify for a distribution. But a subsequent order extending duty by an additional 60 days may allow the individual to qualify.

AMOUNT AVAILABLE

The plan sponsor has discretion as to the amount available for distribution. The terms of the plan should outline how the distribution amount is determined. The IRS provides three options:

1. The entire amount elected for the health FSA for the plan year minus any reimbursements received as of the date of the QRD request;
2. The amount contributed to the health FSA as of the date of the QRD request minus any reimbursement received as of the date of the QRD request; or
3. Some other amount (not exceeding the entire amount elected for the health FSA for the plan year minus reimbursements).

If the plan fails to indicate how it determines the amount available, then the amount available is based on #2 above.

¹ As defined by 37 U.S.C 101 to include:

- A) the Army National Guard,
- B) the Army Reserve,
- C) the Navy Reserve,
- D) the Marine Corp Reserve,
- E) The Air National Guard,
- F) the Air Force Reserve,
- G) the Coast Guard Reserve, or
- H) the Reserve Corps of the Public Health Service.

The health FSA must be in existence on or after June 18, 2008. A QRD may not be made with respect to amounts:

1. Forfeited on or before June 18, 2008,
2. Attributable to a prior plan year including a plan year that ended on or before June 18, 2008, or
3. Attributable to non-health FSAs (for example dependent care FSA, or HSA).

CAFETERIA PLAN PROCEDURES

The cafeteria plan may specify procedures for a participant to request a QRD. The employer may specify how many QRDs a participant may receive in the same plan year. For expenses incurred prior to the date the QRD is requested, the plan must permit the employee to submit health FSA claims and reimburse those substantiated expenses. However once a QRD is requested the plan may either:

1. Permit the employee to continue to submit health FSA claims incurred before the end of the FSA plan year (and grace period if applicable); or
2. Terminate an employee's right to submit claims.

MAKING DISTRIBUTIONS

An employer must pay the QRD to an employee within a reasonable time and no later than **60 days** after the request was made.

CAFETERIA PLAN NONDISCRIMINATION REQUIREMENTS

QRDs must be uniformly available to all plan participants. The amounts provided under a QRD are disregarded for purposes of nondiscrimination requirements.

TAXATION

The QRD is included in the gross income and wages of the employees and is subject to employment taxes. The employer must report the QRD on the employee's W-2 for the year in which the QRD is paid.

EFFECTIVE DATE

Applies to QRDs made on or after June 18, 2008.

EMPLOYER ACTION

1. Determine whether you wish to offer QRDs under your health FSA. If so, amend your plan document to incorporate the provision by December 31, 2009. Communicate the availability of this option to your plan participants. Provide a summary material modification with respect to your health FSA incorporating this amendment.
2. If you decided to allow QRDs prior to receipt of this guidance, ensure that no such distribution was made prior to June 18, 2008. Amend your plan retroactively back to the date of the first QRD by December 31, 2009. Communicate the availability of this option to your plan participants. Provide a summary material modification with respect to your health FSA incorporating this amendment.

RESOURCES:

- Notice 2008-82 (9/30/2009) <http://www.irs.gov/pub/irs-drop/n-08-82.pdf>

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