

## **Flexible Spending Accounts – Some Relief from the “Use It or Lose It” Rule**

Flexible Spending Accounts, or FSAs, are a popular benefit offered by many employers. FSAs are the component of an IRC Section 125 cafeteria plan that allows employees the option of pre-tax payroll deductions for use in paying qualified expenses. These expenses may include child care costs, which are fairly easy to discern in advance, or uninsured medical expenses, which may be more nebulous. While FSAs are a popular benefit, the dilemma is that the amount set aside annually must be determined by the employee at the start of the plan year. If the funds are not used, the employee forfeits them at the end of the year. Many times, participants recognize that they overestimated their expenses for the year and spend the last few weeks of the year trying to incur medical expenses through visits to the ophthalmologist, the dentist, and the like. Finally, some relief is being offered to plan participants.

The efforts of those who have lobbied for changes to the so-called “use it or lose it” rule have paid off. Through the issuance of Notice 2005-42, the Treasury Department and the IRS have offered a way to give some relief to participants through a “grace period.” For employers that choose to implement this, the grace period allows participants up to two and one half months after the end of a plan year to incur expenses and pay for them using money from the previous year. So, FSA participants have exactly 14 months and 15 days to use those pre-tax dollars before they are forfeited. While this affords some relief, it is important to note that this does not eliminate the “use it or lose it” rule, so you can still lose some dough.

The moral of the story for employees is to be judicious when determining the amount to be set aside annually. Also, remember that if your employer does offer a grace period and you have funds remaining from the prior plan year, any expenses will count toward the previous plan year first -- until the end of the extended coverage period, of course. Employers need to be mindful that a plan amendment must be implemented before the end of the plan year to provide the grace period to employees.

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