

## Part III - Administrative, Procedural, and Miscellaneous Cafeteria Plans

Notice 2008-82

### PURPOSE AND BACKGROUND

Section 114 of the Heroes Earnings Assistance and Relief Tax Act of 2008 (the HEART Act), enacted June 17, 2008, Pub. L. No. 110-245, amended section 125 of the Internal Revenue Code to provide a special rule allowing distributions of unused amounts in a health Flexible Spending Arrangement (health FSA) to reservists ordered or called to active duty. Section 114 of the HEART Act applies to distributions made on or after June 18, 2008.

Generally, new subsection 125(h) provides that a plan or other arrangement does not fail to be a cafeteria plan or health FSA merely because the arrangement provides, in certain circumstances, for “qualified reservist distributions” (QRDs) to an employee of all or a portion of the balance of the employee’s unused amounts in the health FSA. This notice provides guidance on QRDs from health FSAs. It also includes a transition rule allowing plans to be retroactively amended for QRDs made before January 1, 2010.

### QUALIFIED RESERVIST DISTRIBUTION

In general, a QRD is a distribution to an individual of all or a portion of the balance in the employee’s health FSA if: (1) the individual is a member of a reserve component ordered or called to active duty for a period of 180 days or more or for an indefinite period and (2) the request for 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, under Prop. Treas. Reg. § 1.125-1(e)) that includes the date of the order or

call to active duty. QRDs are an exception to the rule that a health FSA may not make distributions other than reimbursements of substantiated medical expenses. See Prop. Treas. Reg. § 1.125-6.

#### QRD OPTIONAL WITH EMPLOYER

A cafeteria plan is not required to provide for a QRD. The decision of whether to allow a QRD from a health FSA is optional with the employer.

#### PLAN MUST BE AMENDED

A QRD may not be made before the cafeteria plan is amended to provide for a QRD from a health FSA. Pursuant to the requirements of Prop. Treas. Reg. §1.125-1(c), a plan may be amended at any time on a prospective basis. The QRD amendment must apply uniformly to all participants in the cafeteria plan.

#### TRANSITION RULE FOR QRDS MADE BEFORE JANUARY 1, 2010

Notwithstanding the general rule that amendments to cafeteria plans and health FSAs may only be effective prospectively from the date of the plan amendment and that a QRD may not be made before the cafeteria plan is first amended to provide for QRDs, a plan may be amended retroactively to permit QRDs requested on or before December 31, 2009, provided that the QRD satisfies the other requirements in this notice. The retroactive amendment must be made by December 31, 2009, and be effective retroactively to the date of the first QRD paid under the plan, but not prior to June 18, 2008. This transition rule does not extend the period during which an employee may request a QRD. Thus, regardless of when the plan is amended, the transition rule does not allow an employee to request a QRD with respect to a plan year after the last day of

the plan year (or grace period, if applicable) during which the order or call to active duty occurred.

#### EMPLOYEES WHO MAY RECEIVE QRDs

An employee who is, by reason of being a member of a reserve component (as defined in 37 U.S.C. § 101<sup>1</sup>), ordered or called to active duty for a period of 180 days or more or for an indefinite period may request a QRD. An individual ordered or called to active duty before June 18, 2008 is eligible for a QRD if the individual's period of active duty continues after June 18, 2008 and meets the duration requirements in this notice. A QRD may not be made based on an order or call to active duty of any individual other than the employee, including the spouse of the employee.

After an employee requests a QRD and before the employer may distribute an amount, the employer must first receive a copy of the order or call to active duty. An employer may rely on the order or call to determine the period that the employee has been ordered or called to active duty. If the order or call specifies that the period of active duty is for 180 days or more or is indefinite, the employee is eligible for a QRD, and the employee's eligibility is not affected if the actual period of active duty is less than 180 days or is otherwise changed.

If the period specified in the order or call is less than 180 days, a QRD is not allowed. However, subsequent calls or orders that increase the total period of active

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<sup>1</sup> Under paragraph 24 of section 101 of title 37 of the United States Code, the term "reserve component" means--

- (A) the Army National Guard of the United States;
- (B) the Army Reserve;
- (C) the Navy Reserve;
- (D) the Marine Corps Reserve;
- (E) the Air National Guard of the United States;
- (F) the Air Force Reserve;
- (G) the Coast Guard Reserve; or
- (H) the Reserve Corps of the Public Health Service.

duty to 180 days or more will qualify an employee for a QRD. Thus, for example, if an employee is ordered or called to active duty for 120 days, and his or her order or call is subsequently extended for an additional 60 days, that individual qualifies for a QRD.

#### AMOUNT AVAILABLE AS A QRD

If a cafeteria plan provides for QRDs, the cafeteria plan amendment should indicate how the plan will determine an employee's health FSA balance for purposes of making QRDs. See uniform coverage rules in Prop. Treas. Reg. § 1.125-5(d). The cafeteria plan may provide that the amount available as a QRD will be:

(1) the entire amount elected for the health FSA for the plan year minus health FSA 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 health FSA reimbursements 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 cafeteria plan amendment does not indicate how the plan will determine the amount available as a QRD, then the amount available shall be the amount contributed to the health FSA as of the date of the QRD request minus health FSA reimbursements received as of the date of the QRD request.

A QRD may only be made with respect to an employee's health FSA balance 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 ending on or before June 18, 2008), or (3) attributable to non-health FSAs.

## CAFETERIA PLAN QRD PROCEDURES

The cafeteria plan may specify a process for employees to request a QRD. The cafeteria plan may specify how many QRDs may be made with respect to an employee during the same plan year. A plan must permit an employee to submit health FSA claims for medical expenses incurred before the date a QRD is requested and must pay or reimburse substantiated claims for those medical expenses. With respect to medical expenses incurred after the date a QRD is requested, the plan may either:

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

## WHEN TO REQUEST A QRD AND MAKE A DISTRIBUTION

An employee must request a QRD on or after the date of the order or call to active duty, and before the last day of plan year (or grace period, if applicable) during which the order or call to active duty occurred. An employer must pay the QRD to the employee within a reasonable time, but not more than sixty days after the request for a QRD has been made. A QRD may not be made with respect to a plan year ending before the order or call to active duty. In addition, a QRD may only be made on or after the effective date of amendment of the plan to provide for QRDs. But see above for a transition rule for QRDs made before January 1, 2010.

## CAFETERIA PLAN NONDISCRIMINATION RULES

QRDs must be uniformly available to all plan participants. The QRD amounts are disregarded for purposes of the cafeteria plan nondiscrimination rules.

## TAXATION OF A QRD

A QRD is included in the gross income and wages of the employee, and is subject to employment taxes. The employer must report the QRD as wages on the employee's Form W-2 for the year in which the QRD is paid to the employee. The amount reported as wages is reduced by any amount in the health FSA representing after-tax contributions (such as COBRA continuation premiums).

## EFFECTIVE DATE

New section 125(h) is effective for a QRD made on or after June 18, 2008.

## EFFECT ON OTHER DOCUMENTS

Future guidance will amend the § 125 Income Tax Regulations to provide an exception for QRDs as described in new § 125(h).

## COMMENTS REQUESTED

The IRS and the Treasury Department request comments on the amendment made by section 114 of the HEART Act, including the guidance set forth in this notice and on any other issues concerning QRDs.

Comments should be submitted on or before [Insert date ninety days after publication], and should include a reference to Notice 2008-82. Send submissions to CC:PA:LPD:PR (Notice 2008-82), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered **Monday through Friday** between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2008-82), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the

following e-mail address: *Notice.comments@irscounsel.treas.gov*. Please include “Notice 2008-82” in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

#### DRAFTING INFORMATION

The principal author of this notice is Mireille Khoury of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other individuals participated in its development. For further information regarding this notice contact Ms. Khoury at (202) 622-6080 (not a toll-free call).