

**DEPARTMENT OF CIVIL SERVICE**  
**Employee Benefits Division**  
**PO Box 30002, Lansing, Michigan 48909**  
**EMPLOYEE BENEFITS BULLETIN**

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Benefits Bulletins are issued to employees and others to communicate general benefits information.

**FROM:**

Employee Benefits Division

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**SUBJECT:**

**Flexible Spending Account IRS Notice 2005-42**  
**Grace Period Extension**

IRS Notice 2005-42 allows employers to amend their Medical Care and Dependent Care Flexible Spending Account Plans to allow reimbursement for expenses incurred during a two-and-a-half-month grace period after the end of the plan year. Previously State of Michigan employees had to incur claims by December 31 or forfeit unused funds (the use it or lose it rule).

The State of Michigan is implementing the full grace period extension for both the Medical Care and the Dependent Care Spending Accounts beginning with the current 2005 Plan Year.

As a participant in the 2005 Flexible Spending Accounts, you will have until March 15, 2006 to incur eligible claims. The "run out period", which is the time you have to submit claims and substantiating documentation, will end April 15, 2006.

Please see the attached 2005 Medical Care and Dependent Care Flexible Spending Accounts Grace Period Questions and Answers for additional information.

Attach.: 2005 Grace Period Questions and Answers

# 2005 Medical Care and Dependent Care Flexible Spending Accounts Grace Period Questions & Answers

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The Internal Revenue Service approved Notice 2005-42 in May 2005. This notice permits a **grace period** of 2 months and 15 days following the end of each plan year during which unused contributions in either your Medical Care or Dependent Care Spending Account may be reimbursed for qualified expenses **incurred** during the grace period.

This means that since the State of Michigan's Spending Account plan year will end on December 31, 2005, **you may incur qualified expenses up to March 15, 2006**, and use any remaining funds from your 2005 plan year account.

The grace period should not be confused with the **run-out period** which is the period during which you may submit claims for reimbursement out of your prior plan year's account. The State of Michigan's new run-out period ends on April 15, 2006. This means that you will have until April 15, 2006, to submit claims for reimbursement for expenses for the 2005 Plan Year.

The following are some basic questions and answers to help you understand how this Revenue Notice may affect your Medical Care or Dependent Care Spending Accounts.

## How does the Revenue Notice affect my Flexible Spending Account?

The IRS Revenue Notice allows you to incur qualified Flexible Spending Account expenses for the current plan year until March 15 of the following year, and to be reimbursed with remaining funds from your prior plan year's account. For example, if on January 1st you have money left in your prior plan year's account, you can incur expenses up until March 15. These expenses will be paid from your prior plan year's account until it has been exhausted.

## What is a grace period?

A grace period is the 2 months and 15 days immediately following the end of the plan year, in which you or your qualified dependent can incur qualified expenses and use any remaining funds from the prior plan year's account balance. The State of Michigan's grace period is January 1 through March 15.

## What is a run-out period?

A run-out period is the period of time in which a participant has to submit claims for reimbursement out of the prior plan year's account. The State of Michigan's run-out period ends April 15.

## What happens to my claims during the grace period if I have a Flexible Spending Account for the previous and current year?

Claims will be paid in the order in which they are received. If you have an account balance in your 2005 account, and a claim is received with a date of service between January 1, 2006, and March 15, 2006, the expense will be paid from your 2005 account first. If the claim is larger than your 2005 account balance and you have a 2006 medical care spending account, the remainder will be paid from the 2006 account. If a claim is received at a later date, with a date of service in 2005, and all funds have been paid from your 2005 account, the claim will not be paid.

For this reason, **it is important to file claims as soon as your expenses have been incurred**. This will help ensure that you maximize the use of your accounts for both plan years.

## Can I tell you which plan year I want my claims to be paid from?

Claims will be paid in the order in which they are received. You may not request a claim to be paid from a specific plan year. However, you can control the order in which you submit or file your claims. Always make sure that you submit older claims first to ensure that funds are paid from the previous plan year first.

## How does this change affect the use of my EZ REIMBURSE® Card?

Expenses will be paid in the order in which they are incurred. If you have an account balance in your 2005 year's account, an EZ REIMBURSE® Card transaction will be applied against the 2005 balance.

## How should I calculate my future annual contributions for my flexible spending accounts?

You should continue to use *only the calendar year (12 months)* for calculating expenses for your flexible spending accounts. The new Revenue Ruling is intended to provide a safety net for you only if you have not incurred all of your anticipated expenses during the previous plan year.

## What happens if I do not submit my reimbursement claim for the 2005 plan year by April 15, 2006?

If a reimbursement request is not submitted by the April 15, 2006 deadline for the 2005 plan year, your remaining 2005 funds will be forfeited.

# Grace Period Examples

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### Example 1: First In, First Out Paper Claim

Your 2005 Medical Care or Dependent Care Spending Account balance is \$100 and your 2006 account balance is \$1,000. You incur an eligible \$50 expense on 1/15/06 and submit a paper claim on 1/20/06. The claim will be paid out of your 2005 account, leaving a balance of \$50 in your 2005 account and a balance of \$1,000 in your 2006 account.

You then submit a paper claim for a \$50 expense dated 11/15/05. \$50 is paid out of your 2005 account leaving a \$0 balance in your 2005 account and a \$1,000 balance in your 2006 account.

### Example 2: First In, First Out EZ REIMBURSE® Card and Run-out Claim

Your 2005 Medical Care Spending Account balance is \$100 and your 2006 Medical Care Spending Account balance is \$1,000. You swipe your EZ REIMBURSE® Card for a \$150 medical expense on 1/3/06. The system will automatically split the payment. \$100 will be paid out of your 2005 account and \$50 will be paid out of your 2006 account. Your balances will then be \$0 in your 2005 account and \$950 in your 2006 account.

You then submit a paper claim for expenses dated 11/15/05 in the amount of \$50. The claim is **rejected** since the 2005 account is out of funds.

**Therefore, it is very important that you submit your paper claims/receipts as early as possible. Claims that are incurred during the grace period in 2006, and paid out of the 2005 account balance, including debit card transactions, will not be reversed to pay a claim incurred during 2005 but not submitted prior to a grace period claim.**