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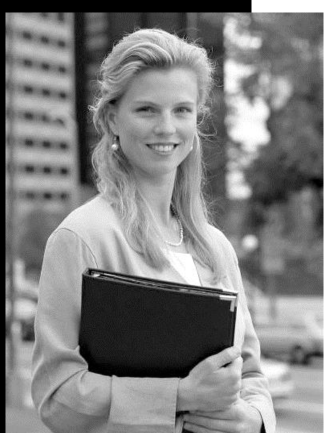
The Employee's Guide to Flexible Spending Accounts



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What is a Flexible Spending Account?

A Flexible Spending Account (FSA), also called a Cafeteria or Section 125 Plan, is a voluntary benefits program offering non-taxable benefits in the following areas:

- Dental benefits;
- Vision benefits;
- Health care benefits; and
- Dependent care assistance.

Contributions for FSA's are taken out of your pay **BEFORE** taxes are applied. This reduces your gross salary and your taxable income.

The three (3) most common Flexible Benefit Plans are:

- Traditional Health Care Spending Account (Health FSA)
- Limited Purpose Health Care Spending Account (LP Health FSA)
- Dependent Care Assistance Plan (DCAP)

What is a Traditional Health Care Spending Account?

A Traditional Health FSA provides coverage under which certain medical expenses may be reimbursed. You can use a Health FSA to pay for medical expenses that can't be reimbursed through insurance or any other arrangement. For example: Insurance co-pays and deductibles (but not insurance premiums), glasses, orthodontia and other health care expenses.

What is a Limited Purpose Health Care Spending Account?

A Limited Purpose Health FSA provides coverage under which only dental and vision expenses may be reimbursed. You can use a Limited Purpose Health FSA to pay for dental and vision expenses that can't be reimbursed through insurance or any other arrangement. This plan is specifically designed for those participants who are enrolled in a Health Savings Account (HSA) Plan, as IRS rules do not permit participation in a traditional Health FSA plan.

What is a Dependent Care Assistance Plan?

A dependent care assistance plan is another type of FSA. You can use a DCAP to be reimbursed for employment-related expenses that allow you and your spouse (if applicable) to be "gainfully employed". Employment-related expenses apply only to certain individuals. Typically, DCAP expenses are those incurred to have a babysitter or day care provider take care of your child (under age 13) while you and your spouse work.

How can an FSA benefit me?

You can benefit from an FSA because:

1. You have the opportunity to choose between cash and non-taxable benefits in a manner that avoids federal income tax, Social Security tax (including the Medicare component), and most state income taxes.
2. You may choose benefits to meet your personal needs and adjust these selections annually.
3. Two-income households may coordinate their benefits.

How does an FSA work?

Each year you decide whether or not you want to participate in a Health FSA and/or DCAP program. If you do, estimate the amount of eligible health or dependent care expenses you are likely to have during the year and decide how much of your salary you want to set aside to help pay for each. The amount you elect will be automatically deducted from your paycheck, prior to being taxed, during the year and credited to your health or dependent care accounts. As you incur eligible expenses during the year, you reimburse yourself from your FSA with tax-free money. *Please be aware that health and dependent care accounts are considered separate benefit plans. Therefore, money cannot be transferred between accounts.*

Can I have my insurance premium(s) come out of my Health Care FSA?

No - Neither a traditional or limited purpose Health FSA permit reimbursement for insurance premiums. These plans may only be used for qualified health care expenses.

What are eligible expenses under a Traditional Health Care FSA?

Under the plan, you will be reimbursed for those types of medical expenses normally deductible on your federal income tax return (without regard to the percentage of adjusted gross income limitation). Eligible expenses include, but are not limited to:

- Deductibles, co-payments and coinsurance;
- Chiropractic treatment;
- Eyeglasses, contact lenses and contact lenses solution;
- Prescribed drugs and/or medications;
- Dental work and orthodontia;
- Routine physicals;
- Hearing exams and hearing aids/batteries;
- Laboratory Fees; and
- Psychiatric Treatment

Although the Internal Revenue Service (IRS) does not set specific limits on the amount of medical expenses that can be reimbursed with a Health FSA, federal regulations require each employer offering this plan to establish annual Health FSA maximums. You will be informed of the maximum annual amount you can set-aside in your account during the open enrollment period each year.

What are eligible expenses under a Limited Purpose Health Care FSA?

Under the plan, you will be reimbursed for those types of medical expenses normally deductible on your federal income tax return (without regard to the percentage of adjusted gross income limitation). Eligible expenses are limited to:

- Eyeglasses, contact lenses;
- Eyeglasses cleaner and contact lenses solution;
- Lasik Eye Surgery;
- Dental work (non-cosmetic); and
- Orthodontia Treatment

What is considered to be an ineligible expense for a Health Care FSA?

Ineligible expenses include, but are not limited to:

- Vitamins, dietary supplements, toiletries, cosmetics;
- Illegal medical treatments;
- Funeral expenses;
- Ear/Body piercing;
- Employment related expenses (physicals, transportation, etc);
- Dental procedures and over-the-counter products to whiten teeth;
- Fitness programs or physical therapy for general health; and
- Cosmetic surgery that is not done for the purpose of meaningfully promoting a proper function of the body or to prevent or treat an illness or disease.

How can I determine if an expense qualifies for reimbursement?

Participants can review a comprehensive list of items that qualify for account reimbursement under IRS Section 213 guidelines by going to **www.medben.com**. To access the Health Care Expenses Table, simply select the *"Plan Members (Insureds)"* button at the bottom of the page then select the *"Additional Resources"* menu at the top of the page and click on *"FSA-eligible Expenses "* option from the drop down menu.

What is considered eligible employment-related expense under a DCAP?

Eligible expenses under a DCAP include employment-related services for dependent care that would be eligible for the dependent care tax credit with the IRS.

Each person for whom you incur the expenses must be a Qualifying Individual – that is, he or she must be:

- A person under age 13 who is your "qualifying child" under the Code (in general the person must: (1) have the same principal abode as you for more than half the year; (2) be your child or stepchild (by blood or adoption), foster child, sibling or stepsibling, or a descendant of one of them; and (3) not provide more than half of his or her own support for the year);
- Your Spouse who is physically or mentally incapable of self-care and has the same principal abode as you for more than half the year; or
- A person who is physically or mentally incapable of caring for him or herself, has the same principal place of abode for more than half of the year, and is your tax dependent under the Code or would qualify as your tax dependent except that (1) he or she has income that equals or exceeds the exemption amount, under the Code; (2) he or she is married and files a joint return with his or her spouse; or (3) you (or your Spouse, if filing jointly) could be claimed as a tax dependent of another taxpayer.

Under a special rule for children of divorced or separated parents, a child is a Qualifying Individual with respect to the custodial parent when the non-custodial parent is entitled to claim the dependency exemption for the child.

- The expenses are incurred for services rendered after the date of your election.
- The expenses are incurred in order to enable you (and your Spouse, if applicable) to be gainfully employed, which generally means working or looking for work. There is an exemption: If your Spouse is not working or looking for work when the expenses are incurred, then he or she must be a full-time student or be physically or mentally incapable of self-care.

Under the plan, you will be reimbursed for those expenses that meet the following criteria:

1. Wages paid to a housekeeper for providing care for a dependent described above, or for related household services.
2. Expenses incurred for care at a facility away from home, such as a family or adult day care center, as long as the dependent spends at least 8 hours a day in your household.
3. Expenses incurred for services provided by an adult or child dependent care center (i.e., a facility that provides care for more than 6 individuals not residing at the facility). The center must comply with all applicable state and local laws and regulations.
4. Wages paid to a baby sitter or companion in or outside the home, as long as the person providing care is not someone you can declare as a dependent.

The reimbursement (when aggregated with all other reimbursements received by you under the Plan during the same year) may not exceed the least of the following limits:

- The maximum allowed under the Plan;
- The reimbursement is larger than the balance in your DCAP account;
- Your taxable compensation (after all compensation reduction elections); or
- If you are married, your spouse's actual or deemed earned income.

The IRS does limit the maximum amount you can deposit in your DCAP to $5,000.00. If you are married and file a separate income tax return, the maximum annual contribution is $2,500.00. If either you or your spouse earns less than these amounts, then your maximum annual contribution would be limited to the amount of your earned income or that of your spouse, whichever is less. If your spouse has no earned income for a plan year, you cannot use this account unless your spouse is disabled or a full-time student for at least five months during the year.

What is the difference between the benefits from the IRS tax deduction and a Health FSA?

Medical expenses can be deducted from your income tax if and only if the medical expenses exceed 7.5% of your gross adjusted income. For example, if your gross adjusted income were $20,000, your health care expenses would have to be greater than $1,500 to claim a deduction ($20,000 x .075). But, keep in mind that you can only declare medical expenses **<u>over</u>** 7.5% of your gross adjusted income. For example, if you had $1,623 in eligible health care expenses, you could only deduct $123 on your tax return.

With a Health Care FSA, you could reimburse yourself with tax-free dollars for any portion of that expense, up to the maximum amount of your yearly contribution. If you use the money from your Health Care FSA for a health care expense, you cannot claim that expense as a deduction on your income tax.

Example of tax benefit when you participate in a Health FSA plan:

John Doe's gross wages for the year was $35,000. His wife, Jane, is a stay-at-home mom and has no income. They have 2 children. John elected to have $1,200 put into a Health FSA, to cover his family's health care expenses that are not reimbursable through his health plan.

	With FSA	Without FSA
1. Adjusted Gross Income	$35,000	$35,000
2. FSA Election	$1,200	$0.00
3. W-2 Gross Income	$33,800	$35,000
4. Federal Income Tax (average 15%)	- $5,070	- $5,250
5. FICA Tax (7.65%)	- $2,586	- $2,678
6. After Tax Expenses	$0.00	$1,200
7. Take Home Pay	**$26,144**	**$25,872**

* John Doe took home $272 more for the year by putting $1,200 into a Health FSA account, which paid for the same medical expenses he would otherwise pay for on an after-tax basis.

* Your actual tax savings may vary depending on your tax situation.

What is the difference between the benefits from the IRS Tax Deduction and a DCAP?

Dependent care expenses can be declared on your income tax return. The tax is determined by applying a percentage to your total work-related dependent care expenses. These expenses may not exceed $3,000 for one eligible dependent or $6,000 for two or more dependents.

Unlike the health care expenses, the IRS allows you to use both a DCAP **and** a tax credit, providing you do not claim the same expenses for both. If you plan to use both, federal regulations require that whatever amount you have directed into a spending account be subtracted from your tax credit.

Keep in mind that in most cases (depending on your filing status), the tax credit is more beneficial than a DCAP if your family income is under $30,000. By selecting the DCAP, your income is not reduced for the purposes of calculating the federal Earned Income Tax Credit.

If you take advantage of a DCAP, you must complete IRS Form 2441 when filing your income taxes for the year. Your employer will report all dependent care contributions on Section 10 of your W-2 form(s).

How much money should I put into my account?

PLAN CAREFULLY. According to federal regulations, once you have designated the contribution amounts for a plan year, you **cannot** change your decision during the plan year unless your family status changes. The following are examples of family status changes:

- Marriage;

- Divorce;
- Birth or adoption of a child;
- Death of a child or a spouse;
- Termination of spouse's employment;
- Commencement of spouse's employment;
- Transition from part-time to full-time work or from full-time to part-time work for employee or spouse;
- Employee or spouse taking an unpaid leave of absence; and
- Any significant change in health coverage of employee or spouse due to spouse's employment.

What if I put too much money into the account and I don't use it all?

If you do not use all of the money allocated into your Health FSA account for expenses incurred during the active plan year, you will be permitted to carry over up to a maximum of $500 of your unused balanced to the following plan year (as long as you are still an eligible plan participant). Any unused amount in excess of $500 remaining at the end of the run-out period for the active plan year will be forfeited. The $500 carry over feature is not applicable to the DCAP plan. Any remaining balance in a DCAP plan will be forfeited.

What if I put too much money into the account and I don't use it all?

If you do not use all of the money deposited into your FSA account(s) for expenses incurred during the plan year, IRS regulations dictate that **ALL OF THE REMAINING FUNDS BE FORFEITED**. Many out-of-pocket health care and dependent care expenses can usually be budgeted ahead of time. Carefully planning your yearly expenses will help reduce the risk of losing unused funds.

Your total tax savings may offset any forfeiture of funds. Remember that a portion of any money would have been paid in taxes.

How do I get reimbursements from my account(s)?

Services must be incurred in order to receive reimbursement from your account(s). Expenses are considered to be incurred the day the service is rendered, not when you are billed, charged or pay for the services. Reimbursements made during a plan year are only made for eligible expenses incurred during that same plan year.

When you submit a claim for your Health Care FSA, you will be reimbursed up to the full amount of your annual contributions, regardless of the amount of money that has been deducted from your payroll. Contributions will continue throughout the year and claims will continue to be paid until your annual election amount is exhausted.

Unlike the Health Care FSA, with your DCAP Account the IRS regulates that you can only take out what you have in the account. For example, if you have a $100 dependent care bill for the month of July, and you only have $50 in the account, you can only get reimbursed $50. When another payroll deduction is made, you will automatically be reimbursed for the balance of your request or the maximum payroll deduction, whichever is less.

What kind of documentation in necessary to receive a reimbursement from my account?

IRS regulations require that an employee furnish a written statement stating that the expense they are requesting reimbursement on has been incurred and they have not been reimbursed nor will they seek reimbursement under the Health Benefit Plan or any other Health Plan, Flexible Spending Plan, Health Reimbursement Arrangement Plan, or Health Savings Account Plan. The Participant does not have to prove the services were paid for; they only have to prove the services were incurred during the applicable Plan Year. The participant must provide supporting documentation from an independent third party, which includes the following:

- A bill or receipt (including date of service, name of patient, provider name-address, amount, and type of service) from a doctor, dentist, or other supplier;
- A prescription receipt (including the date prescription was filled, name of patient, pharmacy name-address, amount, and prescription name) from a pharmacy;
- Explanation of benefits (EOB) statement(s) indicating the deductible, co-insurance and amounts not covered by the medical/dental/vision plan(s) under which the employee or any eligible dependents are covered;
- Store receipts are acceptable for hearing aid batteries, contact lens solution, support braces, reading glasses and other eligible over the counter items. The receipt MUST HAVE the following information printed on the receipt: Store name, date of purchase, Product name and amount of product;
- To obtain reimbursement for over-the-counter (OTC) drugs or medications, a copy of a bona-fide prescription for the medication must be submitted either prior to or at the time of filing the claim for reimbursement. A “prescription” means a written or electronic order for a medicine or drug that meets the legal requirements of a prescription in the state in which the medical expense is incurred and that is issued by an individual who is legally authorized to issue a prescription in that state.

Cancelled checks, handwritten receipts, credit/debit card transaction receipts or previous balance receipts cannot be used to verify an expense. We suggest that you keep their itemized receipts in one place so they’re readily available when you receive a request.

Your HR department will have a supply of reimbursement request forms or you may obtain a reimbursement request form by calling our toll free number, logging onto our website or submitting an email request.

Are there any negatives to an FSA that I should know about?

Yes - Because you do not pay Social Security taxes on your spending account(s) contributions, your Social Security benefits may be less when you retire or if you become disabled. It will depend on the length of time between now and when you retire or become disabled and on whether or not your taxable income exceeds the Social Security maximum wage level.

How often can I change my election amount?

Prior to the first day of each plan year, you will be given an opportunity to modify, change or cancel your benefit election amounts for the next plan year. You cannot change or revoke the election amount during the plan year unless there is a change in family status as mentioned above.

Are there any other terms and/or conditions that I should be aware of?

The Plan Administrator may reduce or cancel your compensation reduction or otherwise modify the agreement in the event they believe it is advisable in order to satisfy certain provisions of the Internal Revenue Code.

The reduction in your cash compensation under the plan agreement shall be in addition to any reductions under other agreements or benefits plans.

The amount of your compensation reduction for each pay period during the year will be credited to your health care FSA and/or DCAP account and such amounts will be paid on your behalf or you will be reimbursed for the applicable expenses incurred during the year.

MedBen is pleased to have been chosen to administer your Flexible Spending Plan. We are committed to providing you with a quality FSA experience. If you have any additional questions please contact:

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