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Employer FAQs for Uses of FSA Forfeitures

Internal Revenue Service ("IRS") rules require health Flexible Spending Accounts ("FSAs") and Dependent Care Assistance Plans ("DCAPs ") to contain a "use-or-lose" provision. Employees elect a dollar amount to contribute to their health FSA and/or DCAP (collectively FSAs) at the beginning of the plan year and submit claims for eligible expenses incurred during the plan year. If the claims incurred by the employee during the plan year and submitted for reimbursement during the year (or during the plan's run out period at the end of the year) are less than the amount of the employee's election, the employee must forfeit any remaining balance. The availability of a grace period of up to 2 ½ months (health FSA and DCAPs) or a carryover amount up to $500 (health FSAs only) reduces, but does not eliminate, the potential for forfeitures. Some employers have chosen not to include either a grace period or carryover provision for a general purpose health FSA because it may negatively affect an employee's or family member's ability to contribute to a Health Savings Account ("HSA") both in the current and following year. However, with or without a grace period or carryover provision, some employees may forfeit amounts at the end of the plan year.

The combination of the uniform coverage rule (the annual dollar election amount must be available to reimburse eligible expenses at all times during the period of coverage) and the use-or-lose rule creates "overpayments" for some FSA participants and "forfeitures" for others. An employee who has claims reimbursed up to the annual election amount early in the year who terminates participation before the end of the year will receive more in reimbursements than the employee paid in salary reduction amounts (overpayments). An employee whose claims reimbursed during the year (and during any grace period and run-out period after the end of the year) are less than the annual election amount will receive less than the amount of his/her salary reduction amounts (forfeitures).

Total forfeitures are determined by adding up the dollar amounts forfeited by each participant whose reimbursement was less than the salary reduction amount. Net forfeitures under the FSA plan will be the total amount forfeited by employees whose reimbursements were less than their annual election amounts reduced by the total amount of overpayments to employees whose reimbursements exceeded their salary reduction amounts. One question thus often arises: What may an employer do (or not do) with those forfeited amounts? Following are a number of FAQs that employers may wish to consider when deciding what to do with forfeitures.

1) ***May an employer use some of the total FSA forfeitures to cover FSA overpayments that result when some participants receive reimbursements that exceed their salary reduction amounts?***

Yes. Many employers will use forfeitures from some participants to cover overpayments to other participants in a health FSA. However, forfeitures from a health FSA may <u>not</u> be used to cover overpayments in a DCAP if the health FSA is an ERISA plan. Even though a DCAP is not an ERISA plan and hence not subject to ERISA's plan asset rules, under IRS rules DCAP forfeitures may only be used for the DCAP, they may not be used under any other plan including a health FSA.

2) Can mid-year election changes have an impact on the amount of forfeitures?

Yes, mid-year election changes can have an impact on the amount of a forfeiture - particularly for a health FSA. In general, mid-year election changes can reduce the potential for forfeitures by permitting employees to make new elections that may better reflect their changed circumstances. For example, if the cafeteria plan includes divorce as a status change that permits a new election (plans typically recognize this event), an employee who is divorced mid-year may want to reduce his/her election to reflect the fact that expenses incurred by the ex-spouse after the divorce are not eligible expenses that can be reimbursed by a health FSA.

Technically, FSAs do not need to permit **any** mid-year changes. Since the health FSA will be an excepted benefit (if not, the employer may face PPACA's $100 per day per affected person penalty), then HIPAA special enrollments are not required. However, the overwhelming majority of plans do permit at least some election changes. Not permitting any changes is likely to be viewed negatively by employees. For example, employees may – with good reason – want to increase an FSA election in the event of marriage or birth of a child or decrease an election in the event of divorce or death of a spouse or dependent. Participation is generally more attractive if employees know they can make adjustments in response to certain major life events.

How the plan handles mid-year election changes may also affect the potential for forfeitures. Two common approaches to the FSA maximum in the event of a mid-year election change are the separate coverage period approach (informally approved by IRS officials) and a blended approach (there is no IRS guidance either formal or informal, but one approach used in the federal government's FSA suggests that it may be permissible. Under the separate coverage periods, each election is treated as a separate period of coverage with its own maximum and salary contribution amount. For example, if an employee elects $2,400 at the start of the year and after six months decreases his election to $600, the employee's benefit amount for the first six months is $2,400 and his salary reduction amount $1,200 ($200 per month x six months). For the second benefit period he selects $600 as his benefit amount and his salary reduction amount would be $600 ($100 per month x six months). In this example, the employee could be reimbursed for as much as $3,000 ($2,400 for the first period of coverage and $600 for the second period of coverage compared to his total salary reduction amount of $1,800). *(Note: It is not clear if/how PPACA's $2,550 health FSA maximum would impact the total reimbursement. It may be permissible if the salary reduction amount for the year does not exceed $2,550)*.

Under the blended approach the employee has a single period of coverage, but with different benefit and salary reduction amounts before and after his election change. His benefit amount for expenses incurred in the first six months would be $2,400 and his salary reduction amount would be $1,200 ($200 per month x six months). For expenses incurred in the last six months, the benefit amount would be a blended maximum of $1,800 ($200 x six months + $100 x six months) minus amounts reimbursed for expenses incurred in the first six months. His salary reduction amounts for the year would be $1,800 ($200 for six months + $100 for six months). Employees are less likely to have forfeitures when the separate coverage period approach is used.

3) What can we do with forfeitures from our health FSA?

What employers may do with plan forfeitures for health FSAs depends upon which rules apply. Specifically, there are two sets of rules that will impact some or all health FSAs.[1] First, there are IRS rules which apply to all cafeteria plans. Second, there are Department of Labor ("DOL") rules which only apply to plans subject to ERISA. ERISA rules apply to health FSAs sponsored by private employers – for-profit or nonprofit – that are subject to ERISA. The ERISA rules do not apply to plans sponsored by employers such as nonfederal governmental plans and churches.

In general, several options may be available for the use of any net forfeitures from a health FSA when both sets of rules apply. The plan may use the net forfeitures for: (1) payment of reasonable plan administration expenses; (2) increasing the amount of the employee annual coverage elections; (3) reducing employees' salary reduction amounts for the immediately following plan year; and (4) returning the forfeitures to participants in the form of taxable cash. If a plan is not subject to ERISA, the employer may retain the forfeited amount.

If an employer uses forfeitures to reduce required salary contributions, increase benefit amounts or distribute as taxable cash, the amount "returned" to each participant may not be related to the amount that the participant forfeited.

Forfeitures under a health FSA may not be "transferred" to a DCAP.

4) How can we reduce the potential for forfeitures under our health FSA?

There are several ways that an employer can reduce the potential for health FSA forfeitures. For example, the plan could: (1) include a grace period of up to 2 ½ months which will give participants additional time to receive services that can be reimbursed by the health FSA; (2) include a carry-over provision of up to $500 which will enable participants to carry over unused funds up to the specified amount that can be used anytime during the following plan year; (3) limit the maximum dollar election; or (4) use a $0 default election at annual enrollment rather than continuing the prior year's election.

A health FSA may have either a grace period or a carryover, but may not have both. The maximum salary reduction amount for health FSAs is $2,550 for 2016. There is no specific dollar limit on employer funds such as a seed or match, but the dollar amount is indirectly capped by the need to have the health FSA qualify as an excepted benefit (one of the conditions is that the total election may not exceed the greater of 2 x the salary reduction amount or the salary reduction amount plus $500).

Many employers include a default election at annual enrollment. Employees who do not enroll on a timely basis by making a positive election for the upcoming year are treated as having chosen to continue their current coverage. For example, an employee with a choice of a PPO, an HMO, or no coverage that is currently enrolled in the HMO would be enrolled in the HMO for the next year. Some employers require employees to make a positive dollar election for the upcoming plan year in order to participate in the health FSA for the upcoming year. An employee who expects significant medical expenses in the upcoming year (e.g., elective surgery is anticipated early in the year) may elect a dollar amount such as $2,000 to cover the expected expenses. Assuming that the elective surgery is not an expected annual

[1] In some cases, state law(s) may apply. Additional issues may also arise under the Davis-Bacon and Service Contract Acts for employers that are contractors or subcontractors working on federally funded or assisted construction projects. Discussion of state and Davis-Bacon and Service Contract Act requirements is outside the scope of this article. Employers should discuss these issues with their tax and/or legal advisors.

expense, this employee may want a lower health FSA election for the following year. The risk is that the employee will forget that he/she has a significant dollar amount elected for the health FSA until after the plan year begins. At that point the employee cannot change his/her election (unless there is a status change that would permit a new election) which may result in a forfeiture at the end of the year. Using $0 as the default election reduces this risk by forcing the employee to make a positive election.

5) What can we do with forfeitures from our DCAP?

Unlike health FSAs, DCAPs are not subject to ERISA. Thus, an employer's handling forfeitures from a DCAP is only subject to IRS rules. In general, several options may be available for the use of any net forfeitures under a DCAP plan: (1) payment of reasonable plan administration expenses; (2) increasing the amount of the employee coverage elections; (3) reducing employees' salary reduction amounts for the immediately following plan year; and/or (4) returning the forfeited amounts to the employer.

If an employer uses forfeitures to reduce required salary contributions, increase benefit amounts or distribute as taxable cash, the amount "returned" to each participant may not be related to the amount that the participant forfeited. For example, if an employee forfeited $100, the plan may not reduce his salary contribution amount by $100, increase his benefit amount by $100, or pay him $100 in taxable cash. Similarly, a plan could not give each employee who forfeited funds a percentage of the amount forfeited by that specific employee. A plan could use a percentage of participants' election amounts as long as the same percentage is provided to all participants – including participants who did not forfeit any funds. Other allocations such as a per capita amount for each participant are also permissible.

6) How can we reduce forfeitures under our DCAP?

Although DCAP forfeitures are possible, they are much less common than health FSA forfeitures for two reasons. First, DCAP expenses are recurring and reasonably predictable; health care expenses are far less predictable. Second, the IRS rules governing status changes are considerably more liberal for DCAPs than they are for health FSAs. In the event that there is a change such as a change in a day care provider, the IRS rules permit the employee to change his/her election.

There are ways that an employer can reduce potential forfeitures under a DCAP. For example, the plan could: (1) include a grace period of up to 2 ½ months, (2) reduce the maximum dollar election amount, and/or (3) use a $0 default election at annual enrolment rather than continuing the prior year's election.

A grace period gives the employee additional time in which to incur expenses that can be reimbursed by the DCAP. The current maximum dollar election permitted is $5,000, however, employers may use a lower amount. Using a $0 default election at annual enrollment forces the employee to select a dollar amount for the upcoming year rather than simply continuing the prior year's election. It reduces the risk that an employee whose need to DCAP benefits is decreasing will continue the prior year's election when a smaller election is what the employee needs.

7) How may an employer use forfeitures from a health FSA that is <u>not</u> subject to ERISA?

Under the proposed cafeteria plan regulations issued in 2007, an employer that is not subject to ERISA has the following options when faced with forfeitures from a health FSA:

a. Use the funds to defray the expenses of administering the plan;

b. Reduce required salary reduction amounts for the immediately following plan year on a reasonable and uniform basis;

c. Increase annual coverage amounts on a reasonable and uniform basis;

d. Return the forfeitures to participants in the form of taxable cash on a uniform and reasonable basis; and/or

e. Retain the forfeited amounts (this option is not available for health FSAs subject to ERISA).

Under IRS rules, forfeitures are not plan assets subject to fiduciary rules such as ERISA's; however, where the plan uses forfeitures to pay for administration expenses, those expenses must be reasonable. If the employer chooses to retain forfeitures, the plan document must contain language giving the employer the right to retain forfeitures and it would be prudent to include language in employee communications advising employees that the employer may retain these funds.

A few employers have donated FSA forfeitures to charity. This option is available only to non-ERISA plans, and the plan document must have language permitting this option.

If an employer uses forfeitures to reduce required salary contributions, increase benefit amounts or distribute as taxable cash, the amount "returned" to each participant may not be related to the amount that the participant forfeited. For example, if an employee forfeited $100, the plan may not reduce his salary contribution amount by $100, increase his benefit amount by $100, or pay him $100 in taxable cash. Similarly, a plan could not give each employee who forfeited funds a percentage of the amount forfeited by that specific employee. A plan could use a percentage of participants' election amounts as long as the same percentage is provided to all participants – including participants who did not forfeit any funds. Other allocations such as a per capita amount for each participant are also permissible.

8) How may an employer use forfeitures from a health FSA that is subject to ERISA?

When a health FSA is subject to ERISA, the DOL views employee salary reduction amounts as plan assets. As a result, net forfeitures are subject to ERISA's fiduciary requirements including the exclusive benefit rule. The exclusive benefit rule requires that the assets of a plan must either be used for the exclusive purpose of providing benefits to participants and beneficiaries or be used to defray the reasonable expenses of administering the plan. Plan assets attributable to the health FSA must be used for the health FSA; they may not be used to pay expenses for any other plan – including a DCAP. In no event may ERISA plan assets be returned to the employer.

For plan assets subject to ERISA's fiduciary requirements, an employer has the following options:

a. Use the funds to defray the reasonable expenses of administering the plan;

b. Reduce required salary reduction amounts on a reasonable and uniform basis for a subsequent plan year;

c. Increase annual coverage amounts on a reasonable and uniform basis; and/or

d. Return the forfeitures to participants in the form of taxable cash on a uniform and reasonable basis (the amount returned must not be related directly or indirectly to the amount forfeited).

If an employer uses forfeitures to reduce required salary reduction amounts, increase benefit amounts or distribute as taxable cash, the amount “returned” to each participant may not be related to the amount that the participant forfeited.

9) May an employer use forfeitures to defray the cost of administering a health FSA that is an ERISA plan?

In general, in order to be an expense that can be reimbursed from plan assets such as forfeitures, the payment/expense must satisfy all of the following requirements:

a. Payment must not be prohibited by the plan document.

b. The expense must relate to administration of the plan. It may not be a “settlor” expense such as the initial expense to design and establish the plan or subsequent design work.

c. The expense must relate to the health FSA.

d. The expense must be reasonable and properly incurred in the administration of the health FSA.

e. The expense must not be an ERISA prohibited transaction.

10) What types of plan expenses can a health FSA subject to ERISA pay from plan assets?

Many employers will use forfeitures to cover the cost of outside services used in the administration of the health FSA such as claims administration. Sometimes, the fees charged by a third-party administrator for adjudicating claims will be less than the amount of the net forfeitures. If forfeitures exceed the cost of the third-party administrator’s services, or if the employer chooses to cover that cost, the remaining amount of the forfeiture may be used to cover other plan administration costs.

In general, ERISA permits the employer to reimburse administration expenses, but not expenses that are called “settlor” expenses. “Settlor” expenses are generally expenses that are incurred in the design and setup of the plan rather than the administration of the plan. See Exhibit 1 for a list of common plan administration expenses that may (or may not) be reimbursed from ERISA plan assets.

The expense must be for administration of the health FSA. Plan administrative expenses could include the cost of a third party administrator used to adjudicate claims, the cost of drafting the plan document and plan amendments, drafting and distribution of a Summary Plan Description and any Summary of Material Modification/Reduction, and preparation and filing of Form 5500. Exhibit 1 lists common plan administration expenses indicating which are permitted (or not permitted) by ERISA.

11) May an employer use net forfeitures to defray its own internal costs for administering a health FSA that is subject to ERISA?

Although, ERISA does permit plan assets to be used to pay for certain “in-house” administration expenses, it is more difficult to satisfy the DOL’s “in-house” rules. It may be permissible to pay certain direct charges such as mailing costs for sending the Summary Plan Description. However, unless the cost is directly related to the administration of the health FSA and properly documented, reimbursing the expense from forfeitures will probably constitute “self-dealing” which is prohibited by ERISA. For example, allocation of expenses such as overhead costs (e.g., rent, computer time, phone expenses) or salaries of employees who work on the plan would not satisfy the DOL’s requirements.

12) What rules apply if an employer decides to return forfeitures to participants in the form of reduced salary reduction amounts, increased annual elections, or taxable cash?

In no event may forfeitures returned to plan participants in the form of reduced salary reduction amounts, increased coverage election amounts, or taxable cash be related directly or indirectly to the claims experience of individual plan participants.

Plans may return forfeitures on a per capita or percentage basis. For example, each plan participant may receive a $10 cash payment or a 10% reduction in required salary reduction amounts for the immediately following plan year. In addition, forfeitures under a dependent care account may only be used for the dependent care account; they may not be used to provide any other type of benefits.

13) May an employer use DCAP forfeitures to increase annual coverage election amounts?

Using DCAP forfeitures to increase annual coverage election amounts may not be feasible given the statutory maximums. The annual maximum under a DCAP is $5,000 ($2,500 if married, but filing separately) and may be further reduced based on earned income levels. As a result the plan might find itself increasing the coverage election amount for some participants, but not others. Unfortunately, this could violate the requirement to allocate forfeitures on a reasonable and uniform basis.

Increasing coverage election amounts for DCAPs also may not be desirable for a number of other reasons. First, since DCAP expenses tend to be relatively predictable and IRS status change rules are more flexible, DCAPs are likely to have minimal forfeitures. If so, the amount allocated to participants could be very small and might not be viewed positively by participants. Second, if the employee has more than one child and wants to use both the FSA and tax credit, it could create a tax filing problem for the employee.

14) Are there any drawbacks to using forfeitures to increase annual coverage election amounts?

One of the major drawbacks may be the timing of the allocation. Because forfeitures cannot be known until after the end of the plan year, allocations to the following plan year will be made after employees have made their salary reduction elections. The additional amount may not be meaningful for some employees. If the employee has already allocated sufficient funds to cover anticipated health or DCAP expenses for the year, the employee may not be able to use the additional amount which would lead to a forfeiture in the following year. Or under a health FSA, employees may use the additional funds for discretionary health care spending such as the purchase of a spare pair of glasses or contact lenses. Further, employees might expect to receive forfeitures in future years, especially if this option is used more than one time. Finally, if the dollar amount is small, it may not be perceived as a "real" benefit by the employee.

15) Which participants should receive an allocation of the forfeitures that are used to increase annual coverage election amounts?

One open issue is which participants should receive an allocation of the forfeitures – should it be participants enrolled in the year in which the forfeiture developed, or can it be participants in the following plan year? IRS regulations do not provide guidance on whether the funds must be used for employees who were participating when the funds were forfeited or if the funds may be used for participants in the following plan year. The DOL regulations are broader and appear to permit plan assets be used for "participants" which ERISA defines as "any employee or former employee…who is or may become eligible to receive a benefit of any type from an employee benefit plan." In the absence of additional guidance, it may be prudent to limit the reduced salary reduction amounts to employees participating when the forfeiture was created.

16) What rules apply if the employer decides to use some or all of the forfeitures to decrease participants' salary reduction amounts?

IRS regulations specifically permit using forfeitures to reduce the salary reduction amount for participants on a reasonable and uniform basis in the following plan year (sometimes called a "premium holiday"). For example, based on the dollar amount of the forfeitures for year one and the dollar amount of elections for year two, the plan may reduce employee salary reduction amounts by 5% so that an employee who elects $1,000 will have a $1,000 benefit, but only have $950 in salary reductions. IRS rules do require that the premium holiday be given in the year following the year in which the forfeiture was created.

ERISA only requires that plan assets be used for the benefit of participants and beneficiaries.

17) Are there any drawbacks to using forfeitures to reduce participants' salary reduction amounts?

Similar to the increase in annual coverage election amounts, timing is a potential drawback to this option. Because forfeitures will not be known until sometime after the employee makes his/her salary reduction election, the employee will not be able to take this amount into consideration when making the decision. If the amount is significant, it could be viewed negatively. For example, the employee may have desired a larger benefit amount, but could not afford a larger salary reduction. In addition, employees could to begin to expect premium holidays, especially if this option is used more than once. Finally, if the dollar amount is small, it may not be perceived as a real benefit.

18) Which participants should receive an allocation of the forfeitures that are used to reduce salary reduction amounts?

Similar to the option to increase the benefit election amount, there is an open question concerning which participants should receive an allocation of the forfeitures – should it be participants enrolled in the year in which the forfeiture was created or can it be participants in the following plan year? The 2007 IRS proposed regulations include an example in which only employees who were participants in the year in which the forfeiture was created were eligible for reduced salary reductions for the following plan year. Unfortunately, the IRS regulations only provide this as an example; they do not indicate if forfeitures may only be used for employees who were participants in the year in which the forfeiture was created. The DOL regulations are broader and appear to permit plan assets be used for "participants" which are defined as "any employee or former employee…who is or may become eligible to receive a benefit of any type from an employee benefit plan." In the absence of additional guidance, it may be prudent to limit reduced salary reduction amounts to employees participating when the forfeiture was created.

19) What rules apply if the employer decides to return some or all of the forfeitures to participants in the form of cash?

Employers may make cash payments provided the amounts are determined on a reasonable and uniform basis. In no event may the amount returned be related directly or indirectly to the amount of the individual participant's forfeiture. Reimbursements that are calculated on a per capita or percentage basis are permissible.

20) Are there any drawbacks to returning some or all of the forfeitures to participants in the form of cash?

Providing forfeitures to participants in the form of cash may not be used as often as other permissible options for several reasons. First, current IRS guidance does not specify which participants should receive cash payments. Thus, the recipient participants could be either employees who were participants in the year in which the forfeitures were created, or employees who are participants in the year in which the refund is paid. The DOL rules would appear to permit payment to either group of participants. Although at first glance this appears to be the simplest option from an administrative standpoint, there are practical issues.

First, if the plan makes payments to employees who were participants in the year in which the forfeitures were created, the plan administrator may need to send payments to former employees. The IRS rules only require a plan to send the cash payment to the most recent address on file; they do not require an employer to track down former employees. However, the DOL rules may require an additional effort to track down employees if refund checks are returned to the plan administrator. Second, the amount refunded is taxable income so the employer will need to withhold payroll taxes and include the amounts on Forms W-2. Finally, if the amount is small it may not be viewed positively by employees.

IRS regulations do not specify the timing for cash payments to participants. DOL regulations do not specifically address this issue, but based on guidance in other situations it would be prudent to make the payments within 12 months after the dollar amount of forfeitures is known.

21) What time limits apply to using net forfeitures to defray the cost of plan expenses? Is an employer permitted to use net forfeitures in one plan year to defray administrative cost in the next or a following plan year?

IRS rules do not specify a time frame for using forfeitures to pay plan expenses. While the DOL has not specifically addressed this issue, based on the guidance they have provided in other areas, it would be prudent to use the funds to cover expenses in the plan year in which the forfeiture developed or the following plan year.

22) If an employer wants to use forfeitures to increase annual coverage election amounts, is there a time limit on when the amounts must be used?

The 2007 IRS proposed regulations include an example in which forfeitures are used to increase the annual coverage election amount in the following plan year on a reasonable and uniform basis. For example, if the total forfeiture allocated per capita is $100, the plan could increase the employee's annual dollar election for the following plan year by $100 so that an employee who elected a salary reduction amount of $1,000 would have a benefit amount of $1,100. (This additional amount does not appear to count toward the $2,550 salary reduction maximum for health FSAs.) ERISA only requires that plan assets be used for the benefit of participants and beneficiaries. Administratively, this option may be simpler than some of the others, but there are several reasons an employer may not choose to increase coverage elections.

23) What documentation and communication requirements must be satisfied?

Regardless of how the employer decides to use FSA forfeitures, those uses must be documented. If forfeitures will be used to increase the annual coverage amounts, reduce the salary reduction amounts, be returned as taxable cash to plan participants, or retained by the employer (where permissible), the plan document must contain appropriate language. If applicable, the plan language should also specify which participants will receive the increased benefit, reduced contribution, or taxable cash.

If any portion of forfeitures will be used to defray expenses for administering the plan, the cafeteria plan document must contain appropriate language giving the plan administrator the authority to reimburse those expenses. The employer will also need appropriate records with information on the amount of the expense, type of expense, the date(s) incurred, and the vendor that provided the service. The documentation should demonstrate that the expenses are directly related to the administration of the FSA. If there are "in-house" expenses that may be reimbursed under current rules, more detailed information and documentation will be required.

Finally, the employer should communicate to employees in general terms how forfeitures under the plan may be used. For example, if any part of the forfeitures will be used to defray the cost of administering the plan, employee communications should include a general statement that forfeitures will be used to cover the cost of administering the FSA.

Gallagher Benefit Services, through its compliance experts and consultants, will continue to monitor developments on healthcare reform legislation and regulation and will provide you with relevant updated information as it becomes available. In the interim, please contact your Gallagher Benefit Services Representative with any questions that you may have.

Exhibit 1

Reimbursement of Plan Administration Expenses from FSA Forfeitures

Type of Expense	ERISA Permitted*
Professional Fees for: • Design Consulting	 No
Professional Fees to draft: • FSA Plan Document • FSA Plan Amendment – Design Change • FSA Plan Amendment – Compliance Requirement	 No No Yes
FSA Claims Administration Fees for: • TPA Claims Services • Stored Value Cards • Banking for Claim Account • COBRA Administration • Nondiscrimination Testing	 Yes Yes Yes, if separate Yes, if separate Yes, if separate
Reporting and Disclosure • Preparation of Form 5500	 Yes, if separate
Costs of FSA Communications to employees: • Draft SPD/benefits Booklet • Draft Enrollment Materials • Printing SPD/benefits Booklet • Printing Enrollment Materials • Postage	 Yes, if separate Yes, if separate Yes, if separate Yes, if separate Yes, if separate
In-House Expenses for FSA Administration: • General Costs • Salaries • Telephone • Office Supplies	 Only if direct expense Only if direct expense Only if direct expense Only if direct expense

**Health FSA forfeitures may not be used to cover expenses for the DCAP.*

Notes:

(1) An expense is "separate" only if it relates solely to the administration of the FSA. For example, if the TPA that adjudicates claims for the health FSA also sends COBRA notices and collects premiums for the health FSA, the expense would be for the FSA. If the TPA (or a COBRA administrator) sends COBRA notices and collects premiums for COBRA that is not limited to the health FSA, then the expense is not separate.

(2) In order to qualify as a direct expense, the expense must satisfy the following: (1) an expense is not "direct" to the extent it would have been incurred had the plan not provided (for example, salaried employees who work on the plan who would be employed if the plan did not exist), and (2) the expense cannot be an allocation of overhead costs such as rent, utilities, computer time, etc.