

# Flexible Spending Accounts

Flexible spending accounts (FSA) are a type of cafeteria plan commonly used by many employers. In an FSA, participating employees generally elect to have their salary reduced each month. The employer then uses these funds to pay for certain benefits with pretax dollars. There are two types of FSAs.



1. Medical expenses not otherwise covered
2. Dependent care expenses for both children and parents

## Tax Benefits

The payment of the benefit is tax deductible for the employer and is not considered additional income to the employee. As these dollars are not considered to be wages, they are not subject to either FICA or FUTA tax.

## Health Benefits

If an FSA provides health benefits (like medical or dental expenses) to participants, it must be ready to pay the full year's benefits to an employee who qualifies for the benefit.

For example, if the employee has contributed for only one or two months at the time of the claim, the employer must pay for the entire expense up to the amount projected for the full year of contributions by the employee.

If the employee then terminates employment before the amounts are deducted from his or her paycheck, the employer must suffer the loss.

## Use It or Lose It

Any unused funds remaining in an FSA at the end of the year will be forfeited by the employee. At the beginning of the year, a careful estimate of future expenses is helpful in avoiding this "use it or lose it" problem. However, employers may (but are not required to) establish a grace period of 2 ½ months after the end of a plan year. During this grace period, any unused funds may be paid or reimbursed to the employee for qualified expenses incurred during the grace period.<sup>1</sup>

---

<sup>1</sup> See IRS Notice 2005-42 (05/19/2005).