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The Benefits Brief…

The Impact Of A Merger Or Acquisition On FSA Accounts

Employer dynamics are constantly changing and questions can arise about the impact of merger and acquisition (M&A) activity on employee benefits and particularly, on participants in a flexible spending account (FSA) plan.

Fortunately, the IRS agrees that participants shouldn't be punished just because their company has merged with another. The participants elected to fund FSA plan elections for unreimbursed medical and dependent care expenses through pre-tax salary redirection. It's a great tax savings, but because the IRS is involved, there are lots of rules and regulations. Often overlooked in all the details of M&A deals is the proper handling of employees' health FSAs.

Generally, FSAs will fall into two categories: employees who have money in their accounts, but not enough expenses incurred to draw on the funds, and participants who have received reimbursements in excess of their year-to-date contributions.

The IRS uses Revenue Ruling 2002-32 to explain exactly how to transfer the balance to the new employer. By using specific facts and circumstances within this revenue ruling, the IRS guides the buyer and the seller on how to continue a participant's health FSA coverage once the company's sale is complete.

The first of the following examples allows for continuation of coverage under the seller's health FSA with salary redirections made under the buyer's plan. The second example illustrates how coverage and salary redirection are handed off to the buyer.

Coverage Continues Under Seller's Plan

The facts in this company merger are as follows: (1) The selling company maintains the health FSA plan; (2) during the plan year, a buyer acquires a portion of the seller's assets; and (3) the seller's employees become employees of the buyer.

The two parties agree that the seller will continue its health FSA plan and coverage for all transferred employees. The buyer must also have an existing health FSA plan or be prepared to adopt a new health FSA plan. Salary redirections take place from the buyer's payroll—the transferred participants are now the buyer's employees. Health FSA participants will continue to seek reimbursement from the seller for the remainder of the plan year.

Example: Joe works for Cellar Sales. He made a $1,200 annual election to his health FSA plan that started on January 1. On July 1, Joe's division was sold and he became an employee of Buy Right. Joe has contributed $600 to his health FSA account, but has incurred no medical expenses to date. Prior to Revenue Ruling 2002-32, Joe would have been considered a terminated employee from Cellar Sales and would have either forfeited his $600 or been able to elect COBRA continuation coverage, if applicable.

With this new ruling, Joe's new paycheck from Buy Right will continue to take his health FSA pre-tax deductions and deposit them into Joe's Cellar Sales' FSA account. He will continue to send future requests for reimbursement to Cellar Sales.

Coverage Is Transferred to Buyer's Plan

The facts are the same as in scenario one, except the buyer agrees to provide coverage for the new employees. Again, the buyer must have an existing plan or will adopt a new plan with salary redirections started through the buyer's payroll account.

All affected plan participants' accounts consisting of contributions and earlier reimbursements are transferred to the new employer. Participants will request reimbursement for expenses incurred either before or after the acquisition from their new employer. The participants enjoy uninterrupted coverage.

Example: Let's look at Joe again with a different set of facts and circumstances. Although Joe has contributed $600 to Cellar Sales' FSA plan, his balance will be transferred to his new employer. Thus, instead of sending his request for reimbursements to Cellar Sales, he will turn in claims to his new employer, Buy Right.

Even if Joe incurred eligible expenses in March, his claim would be submitted to Buy Right and reimbursed from Buy Right's FSA plan, because his account balance was transferred to the new company.

Just a Few Rules

Transferring the participant's accounts means just that. Unless the participant has a valid change of status, no midyear election changes are allowed because of a merger or acquisition. However, keep in mind, both buyer and seller must maintain an FSA plan, and the FSA plans must also allow for the same period of coverage. In other words, both plans must provide coverage based on the same plan year.

Of course, in both scenarios, the seller and the buyer should document the arrangement outside the FSA plan and spell out appropriate financial terms. These arrangements would take into consideration contributions and reimbursements received before the merger.

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