

Solanco School District

Section 125 Flexible Spending Individual Termination Process

Within current IRS rules and Solanco's 125 plan documents employees are afforded certain federal tax advantages to select pre-tax payroll withholding for eligible out-of-pocket medical costs. Under these rules and guidelines the benefit is for active employees only. Active employees may select a certain annual dollar amount during the Section 125 election period (January 1 through December 31), and then 1/26 of that amount is deducted over the course of the year. By rule, an employee may utilize the whole annual elected amount prior to paying all of the installments, however, the installments would still continue. Conversely, an employee may not use any of the funds until the very end of the year, however, incurred dates of the expense must fall within the plan year.

Further, when an employee terminates employment, it is important to understand how any unused funds may be accessed, as well as how any "over-utilized" funds should be reconciled.

When a Section 125 participating employee resigns, retires, or terminates active employment for any reason prior to the end of the calendar year, several things will occur:

1. A reconciliation of paid claims versus payroll contributions will be calculated to-date as well as to the known termination date. This review may need to include projections for 125 claims which are incurred but not submitted, those submitted but not yet paid, as well as payroll payments in-float.
2. The employee's status will be considered "in-active" on the day after they cease to be considered an active employee.
 - a. For most employees this date is their last day of work.
 - b. For retirees:
 - i. For professional staff retiring at the end of a district fiscal year and being paid (balance of contract) over the summer and /or covered by healthcare; this date will be the end of August.
 - ii. For all other staff, the date will generally be their last day of work.
3. The term and action to create "In-active status" in essence *freezes* the amount of funds currently placed in the employees section 125 account, any remaining funds in the account are accessible to the employee as long as submitted eligible medical expenses have an incurred date (on the receipt) *prior* to the termination date.
4. If there is a balance in the former employee's fund, and they do not have any incurred expenses prior to the termination date, the former employee will be eligible for

continuation of coverage of the Section 125 benefit. Generally to enact Continuation of Coverage, the former employee would be required to pay the “monthly” premium (i.e. the monthly Section 125 contracted amount) to the District and that action allows continuation to access funds within the program as contracted. This would include all prior funds as well as the additional month, or months, paid in. Continuation of Coverage election payments are paid after-tax if not covered in payroll prior to an employee's last payroll check.

5. If the former employee has utilized more funds than actually paid in at termination, the district will set up a catch-up deduction in the final paycheck of the employee.

With proper planning and review of section 125 plan funds at termination, employees can be confident they will not “forfeit” any funds, as well as funds paid-in and funds paid-out can be matched up.

Examples: Employee plans to terminate August 30, and they have annual election of \$2,600, or \$100 per pay. There have been 17 pays since January so the employee has paid in \$1,700.

1. Example 1: The employee has not used any of the \$1,700 available, and has no incurred invoices to submit. At termination, the account will be frozen at the \$1,700 level. To gain access to the funds, the employee would need to opt for Continuation of Coverage and pay \$100 in September to the District. This action allows the employee to incur claims to utilize the entire new balance of \$1,800, or the employee could continue paying the monthly contracted amount to reach the entire \$2,400 contracted amount. It is very important to note in this example, if the employee does not opt for Continuation of Coverage, they will forfeit the entire \$1,700.
2. Example 2: The employee has used \$1,922 by the time the 17th payroll is processed. The district will set up an additional deduction of \$222 ($\$1,922 - \$1,700 = \222) for employee review which will reconcile section 125 utilization to actual payroll deductions.
3. Example 3: The employee has not used all of their \$1,700 in available funds; however, the employee is sure they have sufficient “incurred” eligible expenses pre-dating the termination date to use all remaining funds. Those expenses can be submitted after termination date and no employer / payroll action may be required.