

Flexible Spending Accounts:
Helping You Save Money





Save on taxes through FSAs

Flexible Spending Accounts (FSAs) reimburse participants with before-tax dollars for certain out-of-pocket expenses.

Our FSA administration expertise and other broad services make the FSA an easy way to enhance your benefit program. In addition, your tax savings on your Social Security match can also make the FSA an inexpensive new benefit.

It's another fine service from Principal Life Insurance Company (The Principal®), a member of the Principal Financial Group®.



About flexible spending accounts

FSAs use Section 125 of the Internal Revenue Code (cafeteria plans). Within certain limits outlined in the program, employees can direct their before-tax dollars into two expense areas.

Health

The Health FSA provides an excellent way for employees to pay for their medical expenses not covered under your medical coverage (such as deductibles and copayments). FSAs also help employees pay for other qualifying health care expenses.

Dependent care

The Dependent Care FSA appeals to employees who have necessary dependent care expenses, such as child care or elder care. The care must be needed to allow the employee and his or her spouse to work, seek employment or attend school full time. The employer sets a minimum and maximum contribution, keeping in mind IRS rules limit the contribution for each employee to whichever is lowest: employee's income, his or her spouse's income, or \$5,000.

Tax advantages for employers

- You pay no Social Security "match" on amounts employees put into the FSA.
- If you decide to make a contribution to the FSA, you may be able to deduct it as an ordinary business expense.

Tax advantages for your employees

- Reduced federal income tax.
- Reduced state income tax (except in New Jersey, Pennsylvania and states without an income tax).
- Reduced Social Security tax.

Employees pay none of these taxes on FSA dollars used for qualifying expenses – whether the FSA contribution was made by you or your employees.

Employer tax example

| ABC COMPANY HAS 100 EMPLOYEES | WITHOUT FSA | WITH FSA |
|------------------------------------|-------------|----------------|
| Annual salaries | \$500,000 | \$500,000* |
| Health FSA | | \$(15,000)** |
| Dependent Care FSA | | \$(25,000) |
| Taxable salaries | \$500,000 | \$460,000 |
| FICA (Social Security) tax (7.65%) | \$38,250 | \$35,190 |
| SAVINGS | | \$3,060 |

*Based on 15 employees contributing \$1,000 annually.

**Based on five employees contributing \$5,000 annually.



What The Principal does

Provides employee communications

We offer you employee communication materials as a standard part of your FSA package:

- Employee brochures to explain the details (also available in Spanish)
- Election forms for your employees (forms must be signed and dated prior to the effective date of the FSA plan year. Also available in Spanish.)
- A checklist to assist participants when they request reimbursement
- A personalized individual account summary for each employee
- A list of covered and excluded expenses
- Direct deposit of employee's FSA reimbursement into their checking or savings accounts
- Directions accessing personal information on our Web site, www.principal.com

For an additional fee, we can provide fully customized FSA materials to meet your needs.

Assists with your FSA requirements

The law requires you to develop various documents and supply employees with certain information. We're happy to assist you by:

- Preparing your FSA plan document(s)
- Preparing your Summary Plan Descriptions (SPDs) for you to distribute to your participants
- Providing nondiscrimination testing for IRC Sections 125, 105(h) and 129 for an additional fee
- Providing signature-ready Form 5500 if required to file, for an additional fee
- Answering your questions

Helps administer your FSA

The Principal wants our FSA program to work for you. We make it easy by handling most of the administrative work. Here's what we do for you:

- Keep track of all FSA contributions through census reports you provide.
- Supply easy-to-use request for reimbursement forms for your participants.
- Reimburse participants weekly, including an explanation of reimbursement with each payment.
- Provide you monthly FSA Status Reports that summarize contributions and reimbursements for each health and dependent care participant.
- Send you monthly FSA fee-for-service statements showing administration costs.
- Offer you the payment option of having monthly FSA fees electronically transferred from your bank to Principal Life.
- Report disbursement of funds to you through the monthly group claim recorded list*, including Electronic Funds Transfer (EFT) activity from your bank.

*This detailed listing is not available until after the end of the calendar month.



How it works

You don't get involved in a lot of paperwork. Our reimbursement process works to simplify administration.

1. You open a bank account (or use an existing one) to hold FSA payroll deductions.
2. The participant contributes to the FSA through payroll deduction.
3. If dependent care is selected, the participant receives day care services and then files for reimbursement. If health care is selected, the participant receives services and first submits a claim for applicable medical, dental, prescription drug or vision coverage before filing for Health FSA reimbursement.
4. The employee then fills out an FSA reimbursement form and sends it to our service center.
5. We reimburse participants directly each week.
6. We then request an electronic funds transfer (EFT) from your bank account for the amount of the reimbursements because your participants have already been paid. (EFT transfer may occur daily if employees have chosen the debit-card option.)

Participant reimbursement rules

- Reimbursements are made on scheduled day if a participant's reimbursement request meets minimum reimbursement amounts.
- Reimbursement requests must be received no later than 90 days after the end of the plan year.
- Participants can claim reimbursement only for services received during the FSA plan year and during their periods of coverage.
- Employees who terminate employment during the plan year can submit claims up to 90 days from their termination date in the plan.

Optional automated Health FSA reimbursement

For medical, dental or vision benefits issued or administered by Principal Life, we can automatically process Health FSA reimbursements from health care claims we receive. We first pay covered charges under your medical, dental and vision coverage. Any remaining charges that qualify under the Health FSA are then reimbursed to the participant.

This option is open only to participants with no medical, dental and vision coverage other than that issued or administered by Principal Life. (The IRS requires FSA expenses not be reimbursed through any other coverage.)

To use this program, the following tasks must be done before the start of the FSA plan year:

- Notify us that you want to offer the automatic reimbursement program.
- Submit a complete list of participants electing automatic reimbursement.

Optional debit card

This option offers employees easy access to pre-tax dollars set aside in their accounts to cover qualified health or dependent care expenses described under the health care or dependent care plan guidelines. The card is authorized for use only at qualified merchants, health care and child care providers that accept MasterCard® and offer eligible products or services for reimbursement.

Rather than paying money out of pocket for qualified expenses, filling out claim forms, submitting them with covered expense receipts and then waiting for reimbursement, employees will be able to utilize the card to pay for those qualified expenses. Through the card process, funds will be transferred from the employee's health care or dependent care account directly to the provider or merchant to pay for the expense via the MasterCard network.

Employees must always keep their itemized receipts for debit card transactions. IRS rules require The Principal to request copies of those receipts when specific criteria are not met.

Employees will be notified if The Principal needs them to submit copies of their receipts, but they will not have to complete claim forms.

If the debit card option is elected, debit card transactions can occur daily. Employees will automatically receive weekly reimbursements for manual claims. Reimbursement date options are Monday or Tuesday. EFTs may occur daily, based on card usage.



FSA Rules

Participation by owners and partners:

Sole proprietorships, LLC, LLP, partnerships or subchapter S corporations can sponsor FSAs. However, tax law does not allow owners and partners to personally participate.

For S corporations, the prohibition applies to owners with 2 percent or greater stock and their spouses, children, parents and grandchildren employed by the S corporation.

Subject to ERISA

Health FSAs are subject to the requirements of ERISA (Employee Retirement Income Security Act) and provisions of the Internal Revenue Code governing employee benefit plans.

Subject to HIPAA Privacy Rule

Health FSAs are considered group health plans and are therefore subject to the requirements of the HIPAA Privacy Rule (Standards for Privacy of Individually Identifiable Health Information). Because some groups may qualify for an exception to compliance with the HIPAA Privacy Rule, you should consult your own legal advisors on whether and when your Health FSA will need to comply.

Subject to COBRA

In general, COBRA (Consolidated Omnibus Budget Reconciliation Acts of 1985) requirements apply to Health FSAs. Participants leaving employment during the Health FSA plan year will have certain continuation rights. Consult your own legal advisors about any continuation benefits you need to provide.

Subject to FMLA

If a participant goes on a qualifying leave under the Family and Medical Leave Act of 1993 (FMLA), then to the extent required by the FMLA, the (FMLA subject) employer will continue to maintain the participant's Health FSA account on the same terms and conditions as if the participant were still an active employee. If the participant elects to continue coverage while

on leave, then the participant may pay his or her share of the premium in one of the following ways: with after-tax dollars, with pre-tax dollars, by pre-paying all or a portion of the premium, or catch-up under another arrangement agreed upon between the participant and the administrator.

Subject to USERRA

The Uniform Services Employment and Reemployment Rights Act (USERRA) applies to Health FSAs. Contributions, benefits and service credit with respect to qualified military service shall be provided in accordance with USERRA and the regulations. Consult your own legal advisors about benefits you need to provide under USERRA.

Restrictions

If participants use plan dollars to pay an expense, they cannot:

- Deduct that expense from income taxes;
- Apply the expense towards a tax credit; or
- Receive reimbursement for that expense under other benefit plans.

May affect Social Security benefits

Employee contributions reduce wages for Social Security purposes, which could reduce retirement and disability benefits. We recommend participants discuss this with their tax advisors.

Nondiscrimination testing – timing is very important

Under IRS rules for Section 125 plans, your plan may not discriminate in favor of highly compensated or key employees. Violation can create tax consequences for highly compensated employees. FSA plans should be tested both before the plan year begins and during the year. Employees will need to be taxed on any amount in excess of the amount allowed to meet nondiscrimination requirements.



Plan with care

Participants forfeit amounts not used during the FSA plan year for qualifying expenses. The IRS prohibits you from returning these unused funds to participants. For this reason, participants must carefully consider where to direct their FSA dollars.

Unused amounts revert to the plan to help fund benefits and administrative expenses.



What you need to know

Changing FSA contributions

Once participants select a contribution level at the start of the FSA plan year, they may change it only:

- If family status changes due to birth, adoption, divorce, marriage or death;
- If the participant's spouse begins or quits working; or
- If the participant or spouse switches to full- or part-time hours or takes an unpaid leave of absence that affects the participant's eligibility; or
- If the participant leaves his or her place of employment.

If a participant in the FSA leaves the company

A participant who terminates employment usually has two options. He or she can:

- Use his or her existing plan until the end of the plan year and continue contributions through after-tax dollars to a Health FSA only.
- Discontinue contributions and request reimbursements only for expenses incurred before termination. Requests must be submitted within 90 days of the termination date.

Risk-shifting rules

For Health FSAs, the law allows participants to draw up to their total annual contributions any time during the year. For example, a participant making a \$100-per-month contribution could be reimbursed for an expense up to \$1,200 (12 months x \$100) in the first month of the plan year.

An employer would need to have the full \$1,200 available for reimbursement from the start of the plan year. He or she would recoup this as the participant continues to make monthly contributions.

However, the pre-funded amount can be risked if the participant changes contribution levels or leaves the program. Though risk cannot legally be eliminated, employers have several options to help reduce it, including:

- Limiting the maximum contribution.
- Requiring a specific period of employment before employees become eligible.
- We will send you a fax after each reimbursement date to advise you of the overall claim total. This will help you avoid overdrafts and maintain a bank balance greater than the needed amount.

Start now

Our program allows for short plan years, so you can begin right away. Enhance your benefits and save on taxes at the same time. Principal Life makes it easy. Start your FSA today!

Note: This is a summary of the flexible spending account available from Principal Life Insurance Company. Principal Life does not provide tax or legal advice. For information regarding your specific situation, consult your tax and legal advisors.



WE'LL GIVE YOU AN EDGESM

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GP 30885-10 | 11/2006 | © 2006 Principal Financial Services, Inc.