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## Correspondence Memorandum

**DATE:** November 24, 2015  
**TO:** Employee Trust Fund Board  
**FROM:** Jessica Rossner, Program Manager-Employee Reimbursement Accounts  
**SUBJECT:** Healthcare Flexible Spending Account Debit Card 2014 Unsubstantiated Claims

**This memo is for informational purposes only. No Board action is required.**

### Background

In 2014 the Department of Employee Trust Funds (ETF) reported to the ETF Board on the status of efforts to resolve several issues involving the former third-party administrator of the Healthcare Flexible Spending Account (FSA) program. One of those issues concerned 2012 and 2013 unsubstantiated claims of participants in the program. ETF consulted with outside tax counsel as part of the effort to resolve the unsubstantiated claims issue and the other issues regarding this program.

This year ETF found it necessary to develop a response to a remaining issue concerning the FSA program and the former third-party administrator, specifically 2014 unsubstantiated claims. Once again, ETF sought the advice from our outside tax counsel. This memorandum provides an overview on the action taken by ETF to address that issue.

According to the IRS guidelines, participants are required to substantiate all claims made with a Healthcare Flexible Spending Account (FSA) Debit Card to prove the claims are eligible FSA expenses. Substantiation consists of providing documentation, such as an itemized statement, detailed receipt, or an Explanation of Benefits to verify the claims are eligible FSA expenses. The IRS regulations provide specific guidance to the plan sponsor if a participant should fail to substantiate their healthcare FSA debit card claims.

IRS regulations require several steps to be taken in a particular order, such as offsetting the claim with other valid claims, demanding repayment of the overpayment, withholding

Reviewed and approved by Lisa Ellinger, Director  
Office of Strategic Health Policy

Electronically signed: 11/27/15

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from the participant's paycheck, and imputing income, for FSA debit card claims that are not substantiated.

On the basis of advice of tax counsel and ETF's own evaluation of the IRS guidance to resolve the 2014 unsubstantiated health FSA debit card claims, ETF came to the following conclusions:

- An offset approach is not possible for the 2014 unsubstantiated claims because the error did not occur within the same plan year as an offset would occur.
- Several written demands for repayment were made by WageWorks, TASC, and ETF. A final deadline of June 15, 2015, was established for participants to either provide substantiation or make payment for the claims to the plan.
- Due to the State Transforming Agency Resources (STAR) project, Benefit Administration System Project (BAS), shortage of personnel resources and administrative burden, the ability to suppress the 2014 unsubstantiated healthcare FSA debit card claims by the end of the 2015 payroll periods by means of withholding from the participant's paycheck method, were extremely impracticable, if not impossible.

The plan sponsor has the authority to directly impute income to the participant through the administration of plan provisions and necessary compliance requirements under the Internal Revenue Code. As a last resort, the employer, via W-2 Form, must impute taxable income to the participant for the amount of the unsubstantiated healthcare FSA debit card claims incurred.

On November 11, 2015, payroll processing centers and employers were instructed to account for 2014 uncollectible amounts by imputing income on the employee's 2015 W-2 form.

ETF staff are working with the current FSA administrator, TASC, to implement procedures for 2015 and 2016 unsubstantiated claims. We believe the procedures under discussion will provide ETF, payroll processing centers and employers with the necessary tools to address such claims for those two years and beyond.

Staff will be at the Board meeting to answer any questions.