

BRIAN J. LAATSCH

Robert J. Conlin
Secretary, Wisconsin Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931

RECEIVED
WISCONSIN DEPARTMENT OF
EMPLOYEE TRUST FUNDS
DEC -9 AM 9:53

December 5, 2020

Dear Sir:

Out of respect for the adverse effects COVID-19 has had on government operations, I held back this letter until a "new normal" could be established. My point is that even though the events to which I am referring took place in late 2019 and early 2020, I still want to make you aware of them and ask the favor of a reply from your agency. On January 13, 2020, I was informed that a garnishment would be taken from my paycheck to recoup payment to a provider that I made on December 29, 2019. I was told that this was being done "per IRS regulations." My experience with the Employee Trust Fund and TASC staff often left me asking more questions than getting answers. Eventually through my persistence, I was able to get the answers I needed in order to stop further garnishment and recoup the money that had been garnished from my paycheck.

I am writing to you about my experience in the form of remaining questions related to "IRS regulations," to which ETF and TASC staff repeatedly generically referred me. Specifically, I want to draw your attention to ETF and TASC's practices that were lacking in understanding the customer perspective. While I understand that TASC was the agent administering the Employee Spending Accounts for ETF, I expect ETF to hold itself accountable for the agent's shortcomings. My point is that I do not want to hear about the failings of TASC as the source of the issues I experienced. Rather, dysfunctional processes seemed to be the primary source of the issues I experienced, processes which ETF would have had validated before TASC implemented them.

Therefore, I am going to identify ETF as the responsible party for all the issues I experienced and leave TASC out of the narrative. I would not want to see these issues repeated with Connect Your Care, and only ETF can ensure that it does not repeat these issues through CYC. Here are my remaining questions for your consideration:

1. What is the IRS regulatory citation that requires ETF to accept and validate a vendor's debit card transaction when ETF knows full well that the time lag built into its process could not possibly request, let alone receive, substantiating documentation before the end of the calendar year? I authorized Pelsue Orthodontics/Smile Doctors to charge my restricted FSA debit card on December 29, 2019, and the payment was not posted to the online portal until early January 2020.
2. What is the IRS regulatory citation that requires ETF to request substantiating documentation after the close of the calendar year when ETF knows full well that by its policies it would automatically reject the claim for the transaction that was accepted and validated before the end of the calendar year? I received an email on January 3, 2020, asking me to provide substantiating documentation for the December 29, 2019, transaction.
3. What is the IRS regulatory citation that requires ETF to allow participants to submit substantiating documentation online in good faith after the end of the plan year when ETF by its policies would summarily not act in the same good faith upon receipt of the documentation? I was able to submit and receive confirmation of successful uploading of the requested documentation on January 3.

4. What is the IRS regulatory citation that requires ETF to ignore substantiating documentation that it receives shortly after it has accepted and validated the vendor's pre-12/31 debit card transaction? I acted promptly on the request in good faith to provide the substantiating documentation that was requested of me.
5. What is the IRS regulatory citation that requires ETF to take ten calendar days to inform the participant that it has rejected the claim when in fact ETF knows the instant substantiating documentation is submitted after December 31 that the claim would be rejected based on its policies? This delay severely curtailed the time available for me to learn and comply with the remedial process before the garnishment began.
6. What is the IRS regulatory citation that requires ETF to inform the participant in written form that ETF has rejected the claim because the substantiating documentation was received after the plan year's runout period had ended, when in fact the plan year's runout period had not ended? The misinformation I received in writing led me to think that I had no recourse to dispute the determination and prompted me to take aggressive actions to advocate for my rights.
7. What is the IRS regulatory citation that prohibits ETF from informing the participant in writing of the remedial process for resubmitting the claim at the same time ETF notifies the participant in writing it denied the claim? It would be helpful if the written notice of denial directed participants to the remedial process.
8. What is the IRS regulatory citation that requires ETF to instruct the State of Wisconsin Central Payroll to inform participants of the garnishment of their wages before ETF gives written notice directly to the participants of the denials of claims? I was surprised to learn that my salary was going to be garnished in two weeks before ETF informed me that my claim had been denied and the reason for the denial. I hope you can appreciate that this sequence of events is contrary to the spirit of due process rights, even if employees "waive" their due process rights by participating in ESA programs. I would hope that ETF would honor the spirit of due process rights even if IRS regulations permit dishonoring of due process rights.
9. What is the IRS regulatory citation that requires ETF to have a separate, paper-driven process for processing claims after the end of the plan year as opposed to a separate, online process through the same portal participants use during the plan year? Given that automation was still functioning after the end of the plan year, it is odd that ETF would turn to a paper-driven, manual process to approve and deny claims based on the same substantiating documentation that was submitted through the automated process.
10. What is the IRS regulatory citation that requires ETF to in turn require participants to submit the same substantiating documentation multiple times? The substantiating documentation I submitted on January 3 was the same document that ETF processed and accepted in June 2019. It is inaccurate for ETF to claim it did not have substantiating documentation for the December 29 transaction before the end of the calendar year. However, it is true that no ETF system would allow me to link the transaction on December 29 to the substantiating documentation ETF already had on file.

Sincerely,



Brian J Laatsch

Enclosure

Browser tabs: J3 (unread) - bjantsch@yanco... | BREAKING: King leaving UW... | PWM Dashboard | Mail - Laatsch Brian - DCF - C... | Repayments

Address bar: efgpath.fandemand.com/Accounts/Activity/Repayments.aspx

Bookmarks: Apps | Jenneville, Wis. Cur... | St. Paul's Exchange ca... | Find out how your... | TASC | CVC Benefits | http://www-stl... | Fresh Bash Pasta Pa... | Spread up CPU Pro... | Other bookmarks

Denial Details

STATUS DATE	DENIAL EXPLANATION	ACTION REQUIRED	AMOUNT	STATUS
1/10/2020	DNLS - Runout ended - Services were incurred during your Plan year, however, the Plan year runout has ended. Therefore, we are unable to process these claims any longer.	-	\$549.84	Denied

Windows taskbar: Type here to search | 9:09 PM 1/29/2020

RECEIVED
 W/ OFFICE/INSURANCE
 1/29/2020 9:09 AM



STATE OF WISCONSIN
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

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January 22, 2021

BRIAN LAATSCH
1070 LARAMIE LN
JANESVILLE, WI 53546-1851

Dear Mr. Laatsch,

Thank you for reaching out to the Department of Employee Trust Funds (ETF) regarding your experiences with the unsubstantiated claims process with ETF's Third-Party Administrator (TPA), Total Administration Services Corporation (TASC). Secretary Conlin asked me to respond to your inquiries regarding the request for citations from Internal Revenue Service (IRS) Regulations related to ETF procedures and policies for unsubstantiated claims that include garnishment from payroll withholding. I'm including the information below as to how ETF follows the IRS Regulations. If after your review, you still have questions, please feel free to contact me.

Under IRS Regulations, all claims payments made from a Health Care Flexible Spending Account (FSA)/Limited Purpose FSA require third-party validation documentation unless the transaction is auto-validated, such as, pharmacy prescriptions, office visit copays, or Inventory Information Approval System (IIAS) items. Any FSA claims that are not properly validated will follow ETF's Five Step FSA Recovery Policy consistent with the memorandum issued by the IRS Office of Chief Counsel on February 12, 2014 which set forth acceptable correction procedures for any improper payments using a debit card in an FSA.

Step One – Deactivate the Debit Card Until Improper Payment is Recovered

Language From Chief Counsel Memorandum: "Until the amount of the improper payment is recovered, the debit card must be deactivated and the employee must request payments or reimbursements of medical expenses from the health FSA through other methods (for example, by submitting receipts or invoices from a merchant or service provider showing the employee incurred a section 213(d) medical expense)."

ETF Policy: A participant must submit the required substantiation documentation within 45 days of a transaction, or their debit card will be deactivated. A participant can substantiate a claim through the TPA portal, mobile app, or by submitting a claims reimbursement form.

Step Two – Demand Participants Repayment of Unsubstantiated Claim

Language From Chief Counsel Memorandum: “The employer demands that the employee repay the cafeteria plan an amount equal to the improper payment.”

ETF Policy: If an expense requires documentation, the TPA will provide Substantiation Notifications to participants. The TPA will send up to three Substantiation Notifications via mail or email:

- One day after the TPA debit card transaction, notifying the participant that substantiation is required,
- 15 days after the initial TPA debit card transaction, reminding the participant that substantiation is required, and
- 30 days after the initial TPA debit card transaction, as a final reminder that documentation is still lacking.

The TPA provides four additional communications to participants at the end of a plan year (November through December) to substantiate their claims prior to payroll withholding. The communications inform members about the potential of payroll withholding if the claim is not resolved by the end of the plan year. After the end of the plan year, the TPA provides a final unsubstantiated claims report on January 9 of the new plan year to the employers for garnishment payroll withholding. A full week in the new plan year allows any late submission of claims in December to be thoroughly processed prior to payroll withholding.

TASC Action: Claims that are filed late in December during a given plan year are processed through the TASC Claims Department. The TASC Claims Department verifies whether a claim is properly substantiated or if it requires additional documentation based on the IRS requirements. Each claim is reviewed on its own and requires its own documentation. The claim is only moved into the next step of the correction process if the claim requires further substantiation.

The TASC Claims Department processed your December 30, 2019 claim within three business days and completed review on January 2, 2020. The review determined that further documentation was needed for the paid-out claim on December 30, 2019. You were unable to link previous documentation to the December 30, 2019 claim because each claim submitted requires its own documentation.

Claims that have been paid out during the plan year, but still require substantiation cannot be resolved through the TASC portal or mobile app after the plan year has ended. Instead, these must be resolved through the plan correction process paper form. This allows TASC to process substantiated claims against payroll withholding and refund payroll withholding back to the employee. Due to the timing of the debit card usage on December 30, 2019 and TASC’s determination that further documentation was needed on January 2, 2020, this meant your substantiation had to be resolved through paper form.

TASC notified you on January 3, 2020 to request the additional substantiation.

Step Three – Withhold Unsubstantiated Claims from Participant's Pay

Language From Chief Counsel Memorandum: “If, after the demand for repayment of improper payment (as described in Proposed Treasury Reg. §1.125-6(d)(7)(ii)), the employee fails to repay the amount of the improper charge, the employer withholds the amount of the improper charge from the employee’s pay or other compensation, to the full extent allowed by applicable law.”

ETF Policy: Expenses incurred during the plan year, January 1 through December 31, must be resolved no later than 90 days after the end of the plan year. This additional 90-day allotment to resolve unsubstantiated claims is called the run-out period. Unsubstantiated claims that are resolved during the run-out period are considered plan corrections.

If a participant fails to repay the claim or provide the necessary documentation by the end of the plan year, ETF will attempt to recover the claim amount via payroll withholding during the run-out period, pursuant to Wis. Stat. § 40.08(4).

TASC Action: TASC completed a full audit of 2019 claims needing further substantiation and provided the garnishment payroll withholding report to the employers on January 9, 2020. Any 2019 claims that still require substantiation will appear on this report and be recovered via payroll withholding.

Employer Action: You received a notification from your employer on January 13, 2020 regarding the garnishment payroll withholding for the unsubstantiated claim. The employer sends the notification to the employee as a courtesy for the expected payroll withholding.

ETF requires TASC to send seven communications during a plan year to members with unsubstantiated claims. Since your claim on December 30, 2019 was filed at the end of the plan year, you received information about payroll withholding from your employer. The communication from TASC on January 3 was meant to notify you that your claim would be eligible for payroll withholding by your employer if not substantiated.

Step Four – Offset Approach

Language From Chief Counsel Memorandum: “If any portion of the improper payment remains outstanding after attempts to recover the amount (Proposed Treasury Reg. §1.125-6(d)(7)(ii) and (iii)), the employer applies a claims substitution or offset to resolve improper payments, such as a reimbursement for a later substantiated expense claim is reduced by the amount of the improper payment. So, for example, if an employee has received an improper payment of \$200 and subsequently submits a substantiated claim for \$250 incurred during the same coverage period, a reimbursement for \$50 is made.”

ETF Action: A participant must resolve any unsubstantiated claims before the end of the run-out period through the Plan Correction Request Form, or the unsubstantiated claim will proceed to Step Five of the recovery process as a business debt.

In order to resolve an unsubstantiated claim during the run-out period, a participant may:

- Substantiate an unsubstantiated transaction(s) with documentation,
- Substitute an unsubstantiated transaction with another eligible expense, and
- Repay the amount of the unsubstantiated transaction to the TPA.

Employee Action: You substantiated your claim through the Plan Correction form process in mid-January 2020 during the run-out period.

TASC Action: TASC processed your Plan Correction form with the documentation you provided for substantiation. TASC provided you two refund checks on the amounts that your employer had withheld. The refund checks were issued on February 13, 2020 and February 28, 2020.

Employer Action: Your employer stopped garnishment payroll withholding in March 2020 after TASC notified them that your claim on December 30, 2019 had been resolved.

Step Five – Treat Payment as Other Business Indebtedness

Language From Chief Counsel Memorandum: “If, after applying all the procedures described in Proposed Treasury Reg. §1.125-6 (d)(7)(ii) through (iv), the employee remains indebted to the employer for improper payments, the employer, consistent with its business practice, treats the improper payment as it would any other business indebtedness.”

ETF Action: An attempt to collect the unsubstantiated claim-generated business debt using ETF debt collection methods applied to other business debts. The normal debt collection process involves treating the business indebtedness as an improper overpayment and withholds the required amount from the employee’s current pay or any future issued WRS benefit, to the extent possible under Wis. Stat. § 40.08(4).

Upon receipt of the final business debt report from the TPA, the ETF Collections Unit will establish an Accounts Receivable entry in the State Transforming Agency Resources (STAR) system. Participants will receive a collections letter and invoice for the unsubstantiated claim-generated business debt. Monthly statements will be sent to the member as well until the debt has been fully satisfied.

Any plan corrections submitted after the run-out period has ended (March 31) will be denied unless it is determined that the TPA did not correctly process the plan correction.

To conclude, ETF’s Five Step FSA Recovery Policy is consistent with IRS guidance regarding correction procedures for any improper payments. Prior to implementing the procedures with the TPA, ETF met with their tax counsel to ensure that the procedure in

Brian Laatsch
January 22, 2021
Page 5

place is compliant with IRS Regulations. ETF will continue to review our plan correction process and communications with ConnectYourCare (current FSA TPA) and participating employers to help improve the process and clarify communication for employees.

Thank you, again, for contacting ETF. We appreciate the feedback that we receive from members of the FSA program and will consider the feedback for future changes on the members experience. I hope this helps to answer your questions, but if you have additional questions please do not hesitate to reach out to me for further clarification via email Xiong2.Vang@etf.wi.gov or via phone at (608) 266-5875.

Sincerely,

Xiong Vang, HSA and ERA Accounts Program Manager
Office of Strategic Health Policy
Department of Employee Trust Funds

Enclosure

CC: Bob Conlin, ETF Secretary

Brian Stamm, Deputy Director, Office of Strategic Health Policy

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201413006**

Release Date: 3/28/2014

CC:TEGE:EB:HW:

POSTN-105286-14

UILC: 105.00-00, 106.00-00, 125.00-00

date: February 12, 2014

to: Joseph Tiberio, Manager
(SB/SE Employment Tax Policy)
SE:S:SP:ET:ETP

from: Harry Beker, Chief
(Health and Welfare Branch)
CC:TEGE:EB:HW

subject: Correction Procedures For Improper Health Flexible Spending Arrangement
Payments

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

- (1) Whether the correction procedures for debit cards provided in the proposed cafeteria plan regulations may be applied to improper payments from a health flexible spending arrangements (health FSA).
- (2) Whether an employer may alter the order of correction procedures provided in the proposed cafeteria plans regulations.
- (3) In cases in which all other correction procedures have been exhausted and the employer treats the improper payment as business indebtedness, whether the amount of a forgiven improper payment is reported by the employer to the employee on Form W-2 or Form 1099.

LAW AND ANALYSIS

Section 61(a)(1) and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106 provides that “gross income of an employee does not include employer-provided coverage under an accident or health plan.” Section 1.106-1 provides that the gross income of an employee does not include contributions which the employee’s employer makes to an accident or health plan for compensation (through insurance or otherwise) for personal injuries or sickness to the employee or the employee’s spouse or dependents (as defined in § 152).

Section 105(a) provides that “amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.”

Section 105(e) states that amounts received under an accident or health plan for employees are treated as amounts received through accident or health insurance for purposes of § 105. Section 1.105-5(a) provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness. Thus, amounts that are paid to an employee regardless of whether the employee incurs expenses for medical care or suffers a personal injury or sickness are not received under an accident or health plan.

Section 105(b) states that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in § 105(a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in § 213(d)) of the taxpayer or the taxpayer’s spouse or dependents (as defined in § 152) and any child (as defined in §152(f)(1) of the taxpayer who as of the end of the taxable year has not attained age 27.

Section 1.105-2 provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Section 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the taxpayer incurs expenses for medical care.

Under § 125, an employer may establish a cafeteria plan that permits an employee to choose among two or more benefits, consisting of cash (generally, salary) and qualified benefits, including accident or health coverage. Pursuant to § 125, the amount of an employee’s salary reduction applied to purchase such coverage is not included in gross income, even though it was available to the employee and the employee could have chosen to receive cash instead.

Section 125(d)(2)(A) and Proposed Treasury Reg. § 1.125-1(o)¹ generally provide that a cafeteria plan does not include any plan which provides for deferred compensation.

To the extent amounts are excluded from gross income under §§105(b) and 106(a), they are also excluded from income tax withholding under §3401. In addition, amounts paid to reimburse expenses incurred are excluded from FICA and FUTA taxes under §§3121(a) and 3306(b).

Proposed Treasury Reg. § 1.125-5(a)(1) and (b) provide that after an expense for a qualified benefit has been incurred in a flexible spending arrangement, the expense must first be substantiated before the expense is reimbursed. Proposed Treasury Reg. §1.125-6(b) provides rules for substantiation of expenses that must be satisfied before paying or reimbursing any expense for a qualified benefit.

Proposed Treasury Reg. §1.125-6(d)(7) provides the following correction procedures for any improper payments using a debit card.

(i) Until the amount of the improper payment is recovered, the debit card must be deactivated and the employee must request payments or reimbursements of medical expenses from the health FSA through other methods (for example, by submitting receipts or invoices from a merchant or service provider showing the employee incurred a section 213(d) medical expense);

(ii) The employer demands that the employee repay the cafeteria plan an amount equal to the improper payment;

(iii) If, after the demand for repayment of improper payment (as described in Proposed Treasury Reg. §1.125-6(d)(7)(ii)), the employee fails to repay the amount of the improper charge, the employer withholds the amount of the improper charge from the employee's pay or other compensation, to the full extent allowed by applicable law;

(iv) If any portion of the improper payment remains outstanding after attempts to recover the amount (Proposed Treasury Reg. §1.125-6(d)(7)(ii) and (iii)), the employer applies a claims substitution or offset to resolve improper payments, such as a reimbursement for a later substantiated expense claim is reduced by the amount of the improper payment. So, for example, if an employee has received an improper payment of \$200 and subsequently submits a substantiated claim for \$250 incurred during the same coverage period, a reimbursement for \$50 is made; and

(v) If, after applying all the procedures described in Proposed Treasury Reg. §1.125-6(d)(7)(ii) through (iv), the employee remains indebted to the employer for improper

¹ Taxpayer may rely on the proposed regulations under section 125 (§§ 1.125-1, -2, -5, -6 and -7) for guidance pending the issuance of final regulations, as provided in the preamble to the proposed regulations (72 Federal Register 43938, 43944).

payments, the employer, consistent with its business practice, treats the improper payment as it would any other business indebtedness.

For this purpose, an improper payment includes a payment that is not properly substantiated as well as a reimbursement of an expense that is later identified as not a qualified expense.

ISSUE 1

The correction procedures for debit card payments provided in Proposed Treasury Reg. §1.125-6(d)(7)(ii) through (v) may be applied to improper payments under a health FSA.

The employer is the sponsor of the health FSA and is responsible for complying with the rules provided under the Code and regulations. A third-party administrator may apply the overpayment correction procedures on behalf of the employer.

ISSUE 2

The employer may apply the rules of Proposed Treasury Reg. §1.125-6(d)(7)(ii) through (iv) in any order but the order must be consistently applied for all participants in the employer's health FSA. However, the employer may apply the correction method in subsection (v) only after all correction methods in subsections (ii) through (iv) have been pursued by the employer. Forgiveness of improper payments as uncollectible business indebtedness should be the exception rather than a routine process. Repeated inclusion in income of improper payments suggests that proper substantiation procedures are not in place or that the payments may be a method of cashing out unused FSA amounts.

Section 125(d)(2)(A) and Proposed Treasury Reg. §1.125-1(o) generally provide that a cafeteria plan does not include any plan which provides for deferred compensation.

Thus, the correction methods in Proposed Treasury Reg. 1.125-6(d)(7)(ii) through (iv) should be applied during the period of coverage (the plan year) in which the improper payment was made to the participant. To the extent a participant repays the amount of an improper payment, the amount is available for reimbursing other claims incurred in the plan year or, if the plan has adopted a carry-over pursuant to Notice 2013-71, available for claims included in the next plan year (subject to the limitations of Notice 2013-71.)

In cases in which the correction methods in Proposed Treasury Reg. §1.125-6(d)(7)(ii) through (iv) were not applied during the period of coverage during which the improper

payment was made to the employee, the employer should apply Proposed Treasury Reg. §1.125-6(d)(v) in accordance with Issue 3 below.

ISSUE 3

In cases in which all other correction procedures have been exhausted by the employer and the employer treats the improper payment as business indebtedness in accordance with Prop. Treasury Reg. §1.125-6(d)(7)(v), the improper payment should be reported by the employer to the employee as wages on a Form W-2 to the extent the employer forgives the indebtedness after requesting payment consistent with collection procedures for other business indebtedness. The amount included in income is subject to withholding for income tax, FICA and FUTA, since the benefits are made available to the employee by the employer for the performance of services. The improper payment is reportable in the taxable year of the employee in which the indebtedness is forgiven.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 317-5500 if you have any further questions.