

Important notice regarding improper FSA payments



Some IRS requirements regarding flexible spending accounts (FSAs) may require action on your part as an employer. We want you to be aware of steps PacificSource Administrators, Inc. (PSA) is taking to ensure your plan remains in compliance with regulations.

The Office of Chief Counsel for the IRS released a detailed memorandum in 2014 providing guidance on how to correct health FSA payments for expenses that are 1) not properly substantiated or 2) determined to be ineligible for reimbursement based on the documentation provided (improper payments). In this bulletin, we have provided an overview of the memorandum. If you would like to review the original document, you may [download the PDF](#).

If a claim is paid but later identified as an ineligible expense (whether submitted for reimbursement manually, by file, or paid with a benefit debit card at the time of service), the guidance is generally the same. However, benefit debit cards may also be deactivated until the improper payment has been resolved.

Correcting improper payments

Correcting improper payments requires five steps:

- Step 1: Deactivate the card (if applicable)
- Step 2: Request repayment of the ineligible amount
- Step 3: Withhold the payment from compensation (to the extent allowed by law)
- Step 4: Apply a claim substitution or offset for the ineligible amount
- Step 5: Treat the payment as any other business indebtedness (that is, the same steps an employer would take to collect an equivalent business debt)

Steps 2–4 of the correction procedures can be taken in any order, so long as the order is consistently applied for all participants. In contrast, **step 5 may only be applied after the employer has pursued all correction methods in the other steps.**

Reporting improper payments

When step 5 is applied, the employer must first request payment consistent with its collection procedures for other business debts. If the payment is not recovered, the employer may forgive the indebtedness, in which case the payment should be reported as wages on Form W-2 for the year in which the indebtedness is forgiven. The reported amount is subject to withholding for income tax, FICA, and FUTA.

To keep your plan(s) in compliance with IRS guidance, **the following measures** (steps 1, 2, and 4) **are taken by PSA to help correct improper payments.**

- Step 1: Deactivate the debit card (if applicable)
- Step 2: Request repayment of the ineligible amount
- Step 4: Apply a claim substitution or offset for the ineligible amount

After taking these steps to correct improper payments, PSA will provide the information you need to complete steps 3 or 5. The annual year-end summary report will include the total of any unresolved transactions for your employees. If withholding the payment amount (step 3) isn't an option, and you can't recover the funds otherwise, you must report the payments as wages on the employee's Form W-2 (step 5).

Questions? We're happy to help. Please contact your PSA Account Manager.