United States
Office of
Personnel Management
The Federal Government's Human Resources Agency

Benefits Administration Letter

Number: 06-801 **Date: September 14, 2006**

Subject: **The Federal Flexible Spending Account Program (FSAFEDS): Transfer of Funds between the Two Types of Flexible Spending Accounts**

Background

Each year, some employees who enroll in FSAFEDS erroneously select a Health Care Flexible Spending Account (HCFSA) or Dependent Care Flexible Spending Account (DCFSA) when they meant to select the other type of account. Internal Revenue Service guidance allows certain pre-tax elections to be corrected if there is clear and convincing evidence of an error. There were about 800 of these errors in 2005, and approximately 572 through the first six months of 2006. These errors generally fall into one of two types:

1. The employee thinks that he/she needs to enroll in a DCFSA to cover eligible health care expenses for his/her dependents.

   Example: Holly Lawrence enrolls in a Health Care FSA with an annual election of $250 and a Dependent Care FSA with an annual election of $500. By February, she has been reimbursed her full annual HCFSA election. Holly continues to submit claims for otherwise eligible health care expenses, which are denied since her annual election amount has already been reimbursed. When Holly contacts SHPS to question the claims denials, she is surprised to learn that the DCFSA does not reimburse for health care expenses for her dependents.

2. The employee simply selects the wrong account during enrollment and does not realize the error until after allotments begin, or until he/she submits a claim that is denied.

   Example: When enrolling during Open Season, Ann Green inadvertently enters a dollar amount election for a DCFSA. Ann has no children and no other eligible dependents, so she cannot benefit from her mistaken election.

Under FSAFEDS policy, and in accordance with Internal Revenue Service guidelines, these "mistaken elections" can be corrected via Account Funds Transfer (AFT), as long as there is clear and convincing evidence that the election is indeed mistaken. The AFT procedures are discussed below.

Another type of situation may arise if an employee and his/her spouse both elect a DCFSA, and their combined election exceeds the IRS maximum of $5,000 per family. However, this situation does not meet the "clear and convincing" standard of a mistaken election. The couple may receive reimbursement up to the full election of each person and then resolve the withholding error when they file their Federal tax return. They would need to complete Form 2441 (attached to Form 1040), and add the excess pre-tax election back into income. Since the tax return will then show that they have additional dependent care expenses that are deemed to have been paid with after-tax dollars they may be able to use that additional amount to claim a dependent care tax credit on Form 2441. Thus, the extra allotments are not "lost" but can still be used to offset some dependent care expenses.

Account Funds Transfer (AFT) Procedures
Generally, these potentially erroneous accounts are identified by the employee, by reviewing his/her Earnings and Leave Statement, or by following up on a claim that he/she believes to be erroneously processed.

1. The employee contacts SHPS, the administrator of FSAFEDS, or SHPS contacts the employee, depending on who first discovers there may be an error.

2. SHPS determines that an administrative error has occurred, consulting with OPM and/or the BENEFEDS Portal as needed (please refer to BAL 06-203 for information about BENEFEDS).

3. SHPS removes the year-to-date payroll allotments it has received from the employee's payroll provider for the erroneous account and deposits them into the correct account in its billing system, as well as in the employee's account summary.

   Note: the employee may already be enrolled in the other account type, or SHPS may need to create a new account as part of this process.

4. SHPS increases the participant's annual election for the correct account by the amount elected for the erroneous account.

   Example: using Holly Lawrence's example from page 1, SHPS adds $500 to Holly's HCFSA account, the amount of her (erroneous) DCFSA annual election. SHPS then closes her DCFSA account.

5. SHPS, via BENEFEDS, sends the appropriate transaction codes to the employee's payroll provider on the next regular billing file using the agreed-upon file format for the specific payroll provider. This includes:
   - Stopping the allotment for the erroneous account
   - Changing the allotment amount for the correct account or adding the account type if appropriate.

Note: depending on the timing of the next billing file, this process may need to occur over more than one pay period.

6. The payroll provider receives information in a pre-arranged timeframe and format and uses that to ensure that the employee's W-2 will correctly reflect actual elections and pre-tax allotments taken from salary.

7. The payroll provider makes necessary changes within the timeframe such that the employee's W-2 accurately reports pre-tax deductions for the correct(ed) account(s).

<u>Choice of Two Methods</u>
Payroll providers may choose from two methods to process AFTs. Each payroll provider needs to determine which method makes the most sense, based on historic or expected volume, system capability, and other factors. In addition, a payroll provider can elect the manual process as an interim measure until necessary system or other software changes can be made.

<u>Method A: Transfers via billing file (automated)</u>
SHPS will transfer funds from one account to the other. This will be communicated to BENEFEDS, which will send the account funds transfer details to the payroll provider on the next billing file. BENEFEDS will work with the payroll provider to establish the revised billing file layout to include the transfer amount. This information will indicate the amount and other details of the transfer. The payroll provider will adjust the HCFSA and DCFSA amounts accordingly to reflect actual deductions for W-2 reporting purposes.

<u>Method B: Transfers via report (manual)</u>
If the payroll provider is unable to receive transfer details on the billing file (as outlined in Method A above), SHPS, via BENEFEDS, can supply the necessary information for the payroll provider to process the transfer in one of two electronic formats, both transmitted by a secure delivery method.

- Microsoft Excel (spreadsheet)
- Text file

FSAFEDS Administrative Fees
Agencies will not be billed again for employees requiring an account funds transfer. However, fees already billed for the wrong type of account will not be reversed because we assume over time the differences will be negligible and they will balance out.

What We Need From You
We need each payroll provider to complete and fax the attached questionnaire as instructed on the form, by September 30, 2006, to communicate how you wish to handle account funds transfers. Please submit only one questionnaire per payroll provider.

We also need to know if there are any issues or concerns about your agency being able to accommodate this process – whether manual or automated – no later than the end of this calendar year.

If you have any questions or comments about the Account Funds Transfer process, please contact Jeremy Pucko at BENEFEDS via email at jpucko@ltcpartners.com , or send an email to BENEFEDSPortal@opm.gov.

Sincerely,

Robert F. Danbeck
Associate Director
for Human Resources Products and Services

Attachment: Payroll Provider Questionnaire