



KNOWLEDGEABLE INNOVATIVE ESTABLISHED

When a Health FSA participant uses the Benny™ Card for ineligible expenses or fails to substantiate the charge IRS rules provide the following methods of correction:

- 1) substantiation of original charge;
- 2) claim off-set;
- 3) repayment.

If the above measures are unsuccessful the employer may garnish wages (or otherwise demand repayment) to recoup the funds. If repayment or garnishing wages is unsuccessful the employer can treat the charge as any other business indebtedness.

Employers FAQs

Q: Is the Employer required to take any action?

A: The rules require that the card is suspended and repayment or claims offset is requested when charges are not substantiated. Flex-Plan Services handles those aspects of administration. The employer is free to provide the “Benny Statement Instructions” document (see attached). The law is unclear whether the employer is required to deduct the amount from wages. Based on the language in the rules Flex-Plan advises that the employer diligently pursue payment from the employee and/or garnish wages (consistent with state wage withhold laws).

Q: What should the employer do if garnishing wages is not an option (employee is terminated or the deduction is not consistent with state wage withholding laws) and repayment is unsuccessful?

A: Treat Payment as Other Business Indebtedness. If the preceding correction efforts prove unsuccessful, then the employee remains indebted to the employer for the amount of the improper payment. In that event, and consistent with its business practices, the employer may treat the payment as it would treat any other business indebtedness—i.e., the employer takes the same steps it would take to collect an equivalent business debt.

Q: Once the employer has treated the payment as other business indebtedness, can the employer issue a 1099 for the employee?

A: There is no guidance allowing this and we would not advise issuing a 1099 for the unsubstantiated amount.

Q: Once the employer has treated the payment as other business indebtedness, can the employer report the amount on a W-2?

A: Yes, this should be the very last option. IRS and Treasury officials have informally commented that the payment should be reported on Form W-2, regardless of whether the employee is still employed by the employer and that the payment is income in the year in which the debt is forgiven, as opposed to the year in which the expense was incurred.

For example: Assume that the plan year is January 1, 2010 through December 31, 2010. The improper charge occurred in June of 2010. The employer "forgives" repayment of the amount and treats the amount as any other business indebtedness on January 15, 2011. Since the rules state that the "payment is income in the year in which the debt is forgiven" then the employer would issue a W-2 for the 2011 taxable year (issued in January of 2012) for the improper amount.

Q: If the charge is included on the W-2 as income does that affect their annual election or contributions?

A: No, they would still have the same annual and they would still make pre-tax contributions.