



***Retirement and Insurance Service
Benefits Administration Letter***

Number: 01-318

Date: May 18, 2001

Subject: HB-PC Election Processing Errors and Requirement for Retroactive Adjustments

Our policy has been that the correction of administrative errors involving Health Benefits Premium Conversion (HB-PC) cannot include retroactive adjustments to taxable income. This Letter revises that policy by *requiring* retroactive adjustments to taxable income in the event of certain administrative errors related to HB-PC.

Most administrative errors related to HB-PC involve either the deduction of the incorrect amount of FEHB premiums or the failure to process an FEHB plan enrollment or termination. The actions that agency payroll offices (APO) take to correct such errors will also adjust the affected employees' taxable income and tax withholdings, although perhaps in a subsequent tax year. Please see BAL 01-313, "Correction of Administrative Errors - Health Benefits Premium Conversion," for examples of this.

Administrative errors, however, also occur when agencies process elections to participate or waive participation in HB-PC. These errors will result in FEHB premium deductions that are incorrectly designated as "pre-tax" or "after-tax." If they are corrected prospectively, the impact of these errors on the tax liabilities of the affected employees will be permanent. Therefore, when FEHB premium deductions are incorrectly designated as "pre-tax" or "after-tax," taxable income and tax withholdings must be adjusted *retroactively* to the date the HB-PC participation election should have been effective.

The need to retroactively adjust taxable income and tax withholdings in this circumstance is illustrated by the following example:

Bob Lockhart had previously waived participation in HB-PC. He marries (a "qualifying life event") and elects to participate in HB-PC. Although his election to participate in HB-PC should have been effective on November 18, 2001, his employing agency does

<i>Civil Service Retirement System</i>	<i>Federal Employees' Group Life Insurance Program</i>	<i>Federal Employees Health Benefits Program</i>	<i>Federal Employees Retirement System</i>	<i>Long Term Care Insurance Program</i>
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not process it. As a consequence, Mr. Lockhart remains a non-participant in HB-PC and his FEHB deductions are incorrectly designated as “after-tax.” The error is not discovered until in March 2002.

- *If Mr. Lockhart’s taxable income is adjusted prospectively, he will experience an increased tax liability for both tax years 2001 and 2002. To resolve this inequity, Mr. Lockhart’s agency must make his election to participate in HB-PC effective on November 18, 2001 (as it should have been), and adjust his taxable income and tax withholdings retroactively to this date.*

Since the error was detected after Mr. Lockhart’s Form W-2 had been filed for 2001, the APO must file a Form W-2c, correcting his “wages” and tax withholdings for 2001. In addition, the APO must adjust Mr. Lockhart’s current year-to-date taxable income and tax withholdings retroactively to his first pay day in 2002.

In summary, APOs must take the following actions to adjust retroactively taxable income and tax withholdings, when FEHB premium deductions have been incorrectly designated as “pre-tax” or “after-tax:”

If the Error Occurred in the Current Tax Year:

- Adjust year-to-date taxable income and tax withholdings retroactively to the date the HB-PC election should have been effective.

If the Error Occurred in a Prior Tax Year:

- Adjust year-to-date taxable income and tax withholdings retroactively to the first pay day of the current tax year.

-and-

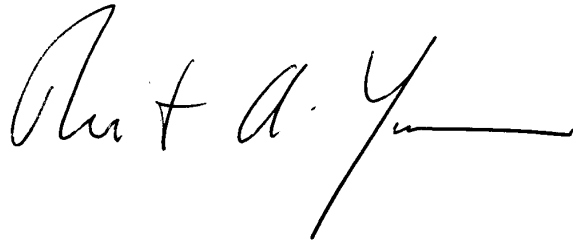
- Correct “wages” and tax withholdings for the prior year(s) by filing corrected W- 2s or W-2c’s.

Following is another common example of a misdesignation of FEHB premium deductions and the corrective action that would be taken by APOs in response:

Ruth Roth, who had previously waived participation in HB-PC, was in leave without pay (LWOP) status from September 2001 through December 2001. Ms. Roth chose to continue her FEHB coverage during her period of LWOP, incurring a debt to her agency for the employee contributions that were remitted to OPM on her behalf. Upon her return to pay status, she elected to participate in HB-PC, but her agency designated her "catch-up" FEHB premium deductions as "after-tax."

Her employing agency has made an administrative error -- as a participant in HB-PC at the time the deduction was taken, Ms. Roth's "catch-up" FEHB premium deductions should have been designated as "pre-tax." To correct its error, the agency redesignates all of Ms. Roth's catch-up FEHB deductions as "pre-tax." Because the error was corrected after the APO filed the Form W-2 for 2001, it files a Form W-2c, correcting Ms. Roth's "wages" and tax withholdings for 2001.

If you have any questions regarding this information, we would prefer that you email us at finance@opm.gov, so that we have a record of our communication. You may also phone us on (202) 606-0606.

A handwritten signature in black ink, appearing to read "Robert A. Yuran". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert A. Yuran, Chief
Financial Policy Staff