



**Retirement and Insurance Service
Benefits Administration Letter**

Number: 01-320

Date: June 29, 2001

Subject: Clarification of BAL 01-318 -- Retroactive Adjustments for HB-PC Processing Errors

We have received several inquiries about Benefits Administration Letter (BAL) 01-318. In that BAL, we revised our policy by requiring retroactive adjustments to taxable income in the event of certain administrative errors involving Health Benefits Premium Conversion (HB-PC). This Letter clarifies one important aspect of the instructions presented in BAL 01-318 for reporting retroactive adjustments to the Internal Revenue Service.

When Federal Employees Health Benefits Program (FEHB) premium deductions are incorrectly designated as “pre-tax” or “after-tax,” BAL 01-318 requires that Federal income tax (FIT) and FICA wages/withholdings be adjusted retroactively to the date that the appropriate HB-PC designation would have been effective. However, IRS regulations as described in Publication 15, preclude the adjustment of amounts reported as FIT withholdings in a prior calendar year in this circumstance. Thus, when it's discovered that FEHB premium deductions have been incorrectly designated in a prior calendar year, FIT withholdings may *not* be adjusted beyond the beginning of the current calendar year.

The revised illustration below reflects this proviso:

Patricia Dickey had previously waived participation in HB-PC. She marries (a “qualifying life event”) and elects to participate in HB-PC. Although her election to participate in HB-PC should have been effective on November 18, 2001, her employing agency does not process it. As a consequence, Ms. Dickey remains a non-participant in HB-PC and her FEHB deductions are deducted “after-tax.” The error is discovered in March 2002.

Ms. Dickey received taxable income of \$50,000 in 2001. Since the error occurred, she had \$900 in FEHB premiums deductions taken from her pay, \$500 of which was deducted in 2001.

Ms. Dickey’s tax year 2001 Form W-2 both “as reported” and as “should have been reported” would be as follows:

W-2	As Reported	As Should Have Been Reported
Gross Pay	50,000	50,000
Pre-tax FEHB Premium Deductions	0	500
Wages, Tips, and Other	50,000	49,500
FIT Withheld	10,000	9,900
Social Security Wages	50,000	49,500
Social Security Tax Withheld	3,100	3,069
Medicare Wages	50,000	49,500
Medicare Tax Withheld	725	718

Ms. Dickey’s APO must adjust her 2002 year-to-date income subject to Federal income taxes and FIT withholdings as well as her FICA wages/withholdings retroactive to the first pay day of 2002. In addition, the APO must file a Form W-2c, correcting her 2001 income subject to Federal income taxes, and her FICA wages/withholdings for 2001. The W-2c reporting for 2001 would be as follows:

W-2c	As previously reported	Correct information	Increase (Decrease)
Wages, Tips, and Other	50,000	49,500	(500)
FIT Withheld	10,000	10,000	0
Social Security Wages	50,000	49,500	(500)
Social Security Tax Withheld	3,100	3,069	(31)
Medicare Wages	50,000	49,500	(500)
Medicare Tax Withheld	725	718	(7)

In summary, APOs must take the following actions when FEHB premium deductions have been incorrectly designated as “pre-tax” or “after-tax:”

If the Error Occurred in the Current Tax Year:

- Adjust current year-to-date income subject to Federal income taxes and FIT wages/withholdings as well as FICA wages/withholdings retroactively to the date the appropriate HB-PC designation should have been effective.

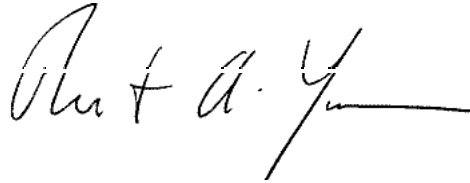
If the Error Occurred in a Prior Tax Year:

- Adjust year-to-date income subject to Federal income taxes and FIT wages/withholdings as well as FICA wages/withholdings retroactively to the first pay day of the current tax year.

-and-

- Correct income subject to Federal income taxes and FICA wages/withholdings for (the) prior year(s).

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