

New Guidance on the Use of Electronic Payment Cards for Health FSAs, HRAs, and DCAPs

On July 11, 2006 the IRS issued Notice 2006-69 providing additional guidance on the use of electronic payment cards (debit cards, credit cards, stored value cards) for health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs). This notice also addresses the use of electronic payment cards for dependent care assistance plans (DCAPs), including dependent care flexible spending accounts. Additionally, the IRS provides some general clarification on other substantiation issues. The following summarizes the relevant information contained in this notice. A copy of the complete notice is located on the IRS website at <http://www.irs.gov/pub/irs-drop/n-06-69.pdf>.

Electronic Transaction Cards

MULTIPLE CO-PAYMENTS

The initial guidance on electronic payment cards (Rev. Rul. 2003-43, 2003-1 C.B. 935) permitted automatic substantiation of transactions that exactly matched group health plan co-payments. Notice 2006-69 expands the process to allow automatic substantiation for matches of multiple co-payments. Automatic substantiation is permitted when:

1) the group health plan has co-payments in a specific dollar amount, 2) the merchant or service provider has the proper MCC code, and 3) the dollar amount of the transaction equals an exact multiple of not more than five times the amount of the co-payment for a specific service or benefit.

For example, under an employer sponsored health plan office visit co-payments are \$5 per covered individual per visit. The employee takes herself and her two covered dependent children to the doctor's office. Together they incur 3 co-payments totaling \$15. The employee uses her FSA debit card to pay the \$15 charge. The charge is automatically substantiated since 1) the plan co-payment is \$5, 2) the doctor's office has a proper MCC code of a medical service provider and 3) the total amount of the transaction is less than five times the co-payment amount.

However, in the same scenario above, if employee had six children totaling six co-payments the amount would not automatically substantiate since the total is greater than five times the co-payment. Proper documentation would be requested in order to complete the transaction.

The same rules apply for prescription purchases at a pharmacy. Provided 1) the plan has a designated co-payment for the benefit, 2) the pharmacy has the proper MCC code and 3) the total transaction amount does not exceed five co-payments, the transaction will auto-substantiate.

INVENTORY INFORMATION APPROVAL SYSTEM

Inventory control information (such as a SKU number) may be used to determine whether a product meets the IRS Code § 213(d) definition of an eligible medical expense. Debit card vendors have partnered with pharmacies and other eligible retailers to develop and implement this technology. The IRS guidance permits automatic substantiation of an electronic payment card transactions when a product's SKU number meets the § 213(d) definition. However, if a participant purchases either a non-recognized or ineligible expense, the transaction will not auto substantiate and the participant will have to submit proper documentation to complete the transaction. Additionally, a record keeping system must be maintained in accordance with IRS requirements for these transactions beginning after December 31, 2006.

Dependent Care Account

Electronic payment cards may be used to provide benefits under a dependent care flexible spending account. However, dependent care expenses may not be reimbursed until service is rendered. Dependent care services are rendered when the dependent care service is provided, not when it is billed, charged or paid for by the participant.

Other General Substantiation Issues

DIRECT THIRD-PARTY SUBSTANTIATION

A third party (a doctor's office, insurance carrier, pharmacy) may submit documentation to process an eligible expense under a participant's FSA or HRA. Most typically a third party would submit an Explanation of Benefits (EOB) to the employer or plan administrator responsible for claims processing. Provided this information contains the date of service, a description of the § 213(d) eligible service and the participant's payment responsibility (amount not subject to insurance) the claim is fully substantiated.

PROHIBITION AGAINST SELF-CERTIFICATION

All medical expenses submitted for payment through an FSA or HRA must be substantiated by third party documentation. Self-certification or self-substantiation is not permitted.

Action Items

1. If you are using a debit card to process Health FSA, HRA or dependent care flexible spending accounts inform participants of the new multiple co-payment rules.
2. Make sure your debit card vendor or TPA, if they are using an inventory control system, is compliant with record keeping requirements after December 31, 2006.
3. If you are interested in offering a debit card, talk with your flexible spending account administrator or your client service team at Kibble & Prentice.