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Health Plan Charge Cards: The Next Wave?

The IRS recently released an advance copy of Revenue Ruling 2003-43 (the "Revenue Ruling") which gives guidance to employers who provide (or would like to provide) expense reimbursement under health flexible spending arrangements (FSAs) or health reimbursement arrangements (HRAs) through debit or credit cards.

Background - Health FSAs and HRAs

Employers establish a health FSA and/or HRA to provide tax-free medical expense reimbursement to employees. An employee who incurs medical expenses which are not otherwise covered or reimbursed (*e.g.*, copayments) may be reimbursed for such expenses by participating in the FSA or HRA. If the FSA or HRA is established and maintained in accordance with IRS rules, the amounts reimbursed are excluded from the employee's gross income.

Under a traditional health FSA or HRA, an employee pays for medical expenses when incurred out of his or her pocket and then seeks reimbursement from the employer. In many instances, this involves paperwork for the employee and the employer. For years, employers, carriers and providers have wanted to be able use credit or debit cards to facilitate payment of health expenses but found there were many technology and regulatory issues. The Revenue Ruling confirms that an employer can establish an FSA or HRA that allows the employee to pay for such expenses with a debit or credit card issued by the employer and addresses some, but not all, of the related substantiation issues.

Substantiation Requirement

Whether or not an FSA or HRA uses a debit or credit card system, the IRS requires that before medical expenses are reimbursed, they must be substantiated by the employee. Under a traditional FSA or HRA, typically, this means that the employee must submit a claim form along with a receipt or other documentation that describes the medical expense and provides the amount of the expense. Under an FSA or HRA using debit or credit cards, the substantiation methods are not as clear

because the employee is paying for medical expenses without first substantiating them.

Revenue Ruling 2003-43

The Revenue Ruling addresses two situations involving the use of debit or credit cards that include the following features:

- ◆ The debit or credit card is issued to each participating employee upon enrollment;
- ◆ The employee certifies (at enrollment and each following plan year) that the debit or credit card will be used only for eligible medical expenses which have not been and will not be reimbursed under any other plan;
- ◆ The certification is included on the back of the debit or credit card (employee reaffirms the certification each time debit or credit card is used);
- ◆ The employee is required to retain receipts and other documentation for the expenses paid with the debit or credit card;
- ◆ The balance or credit limit of the card equals the maximum amount of coverage under the FSA or HRA;
- ◆ The use of the card is limited to authorized providers such as physicians, pharmacies, dentists, hospitals, and other medical providers; and
- ◆ The debit or credit card is cancelled upon the employee's termination of employment.

Substantiation Requirements

The Revenue Ruling approved methods of substantiation for medical expenses paid with the debit or credit card, which are summarized as follows:

- ◆ Copayments - No further substantiation is required if the dollar amount of the transaction equals the amount of the employee's copayment under the employer's medical plan.

- ◆ Recurring Expenses - No further substantiation is required if the amount of the transaction equals the amount of previously approved expenses (such as for monthly prescription refills).
- ◆ Real-Time Substantiation - No further substantiation is required if the provider gives information to the employer at the time the debit or credit card is used verifying that the charge is for a medical expense.
- ◆ Other Expenses - A charge that does not fall into one of the above categories should be conditional pending confirmation that the charge was for an eligible medical expense.
- ◆ Expenses Not Paid With the Card - An employer may pay a service provider directly when use of the card is not practical, such as paying a physician after receiving an EOB from an employee.

The substantiation procedures that were not approved involved sampling techniques based on transaction amounts. According to the Revenue Ruling, all reimbursements must be substantiated, even though the ways to do so may fall within one of those described above. The IRS indicated that the regulations for FSAs and HRAs will be updated to reflect these alternatives.

Correcting Card Misuse

Finally, the Revenue Ruling provides guidance on correction methods that may be used when an employer later identifies a reimbursed claim as an ineligible expense. These are summarized as follows:

- ◆ Pay Back - The employee must repay the employer the amount of any ineligible expense.
- ◆ Withholding - The employer may withhold amounts from the employee's wages.
- ◆ Offset - The employer may offset amounts reimbursed for ineligible expenses against future claims for reimbursement.
- ◆ Deny Access - The employer may deny access to the debit or credit card until the amount is repaid.

Conclusion

There are many administrative requirements that employers must consider before implementing an FSA or HRA plan that reimburses health expenses through debit or credit cards. The Revenue Ruling provides clear examples of what employers should and should not do with regard to protecting the tax-free benefits of an FSA or HRA. Monitoring and making the substantiation requirements work will involve significant administrative effort.

Employers who choose to implement debit or credit card systems should carefully review vendor contracts to ensure that the substantiation requirements will be satisfied. Plan documents should also be reviewed and modified, as needed, to address the procedures and safeguards.

If you have any questions about the use of debit or credit card systems with your health plan, please contact the Seyfarth Shaw employee benefits group attorney with whom you work or any employee benefits group attorney listed on the website at www.seyfarth.com.

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