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Debit/Credit Cards and Health Plan Expense Reimbursement

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Employers are continuously striving to provide their employees with efficient, understandable, cost-effective health care benefits. As a result, the direction and shape of health care benefit plans have changed to meet participants' needs. Over the years employees have grown increasingly accustomed to determining for themselves what coverage they require, without having to rely on a "one size fits all" philosophy. In addition, employees are becoming increasingly benefit-plan savvy; they want to know that the part of their paychecks they have budgeted for health related matters are used effectively.

HRAs, FSAs and debit/credit cards

Health flexible spending arrangements (commonly known as health "FSAs") are a method by which employees who incur specified medical expenses may be reimbursed (subject to reimbursement maximums and reasonable conditions) by the employer. Growing in popularity, FSAs are generally a part of a cafeteria plan. They tend to be funded primarily by employee salary reduction contributions or by employee allocation of an employer's flex credits and have a "use or lose" aspect to them.

Health reimbursement arrangements ("HRAs") have made a relatively recent appearance on the employee benefits scene, having been officially designated (as HRAs) by the IRS in a Revenue Ruling dated June 26, 2000. HRAs are never part of a cafeteria plan and, therefore, are not subject to the provisions of the Internal Revenue Code (IRC) Section 125. Instead, HRAs must be funded solely by an employer (not salary reduction contributions) and may allow employees to carry forward funds to subsequent coverage periods.

There are similarities between FSAs and HRAs. Both provide tax-free medical expense reimbursement to employees if certain conditions are met. Both, traditionally, are structured so that an employee will pay for medical expenses and subsequently seek reimbursement from their employer. In addition, both FSAs and HRAs have, in the past, required a large amount of documentation; paper claims were filed for reimbursements of expenses not covered by health care plans.

Debit cards or credit cards used to deduct fees from an FSA or an HRA account balance have proven to be popular with both employers and employees. When debit or credit cards were featured in a benefit plan, sponsoring employers found that employees were more likely to participate. It appeared that employees found the simplification of the process salary reduction contributions and subsequent presentation of an electronic card to a health care provider..... made for ease of participation.

Employers, however, were unclear as to the appropriate use of debit or credit cards. At risk was the sacrifice of favorable the tax benefits. Therefore, employees were still required to produce written certifications that they had not previously received reimbursement for a medical expense. In addition, employees were required to provide the plan with a written statement from an independent party stating that a medical expense had been incurred and giving the

amount of the expense, so that plan administrators would know that all expenses had been legitimate medical expenses. For answers, employers sought guidance from the IRS.

Revenue Ruling 2003-43

In May 2003, the IRS published long awaited guidance addressing the use of employer-issued debit or credit cards to pay for expenses under a FSA or a HRA. Revenue Ruling 2003-43 illustrates its position by using several situational examples. Situation 1 and Situation 3 demonstrate the use of debit/"stored value cards" where all claims must be substantiated prior to reimbursement. Situation 2 demonstrates the use of a credit card, where only certain claims must be substantiated.

SITUATION 1 -Debit/"Stored Value" Card where substantiation of all claims is required

(Note: Meets the requirements of §105(b)).

Major Medical Plan with a fixed co-pay amount; FSA and/or HRA	Debit/"Stored Value" Card Provisions	Electronic reimbursement of medical expenses in conjunction with the FSA and HRA	Substantiating a claim under the FSA or HRA plans
<p>FSA: Contributions are paid pursuant to salary reduction elections under a cafeteria plan.</p> <p>HRA: Employer paid; there are no salary reduction elections. The Plan provides that the HRA is available only after expenses exceeding the dollar amount under the FSA has been paid from the FSA.</p>	<ul style="list-style-type: none"> • Uninsured medical expenses are reimbursable up to a maximum reimbursement amount, determined at the beginning of each year. • Cardholder's use of the card is limited to the maximum dollar amount of coverage available in the cardholder's FSA or HRA. • Card may only be used at merchants and service providers authorized by employer (specified physicians, pharmacies, dentists, vision care offices, hospitals, etc. that have a "Merchant Code") • The cardholder understands that the card will be automatically cancelled when the employee terminates employment. 	<ul style="list-style-type: none"> • Participating employees are issued a card, and certify upon enrollment in the FSA and/or HRA and each plan year thereafter that: <ol style="list-style-type: none"> 1. –the card will only be used for eligible medical care expenses of employee, employee's spouse and dependents. 2. –any expense paid with the card has not been reimbursed and the employee will not seek reimbursement under any other plan covering health benefits. 3. –the employee understands the certifications are reaffirmed each time the card is used. • The cardholder agrees to acquire and retain sufficient documentation (including invoices and receipts) for any expense paid with the card. • When card is used at point-of-sale, merchant/service provider is paid full amount and card is reduced by the same amount. 	<ul style="list-style-type: none"> • Co-Payments: If the dollar amount of the transaction at a health care provider equals the dollar amount of the co-payment for the service under the major medical plan for a specific employee, the charge is fully substantiated and there is no need to submit a receipt. • Recurring Expenses: If the expense is for a "recurring expense" for the same amount, provider, and length of time (i.e. a prescription) no further submission of receipts is required after an initial authorization. • Real-Time Substantiation": If a merchant, service provider or independent third party (i.e. Pharmacy Benefit Manager) verifies the medical expense information at the time and point of charge, no further substantiation is required if the information provided matches the amount of the transaction. <p>These are all conditional pending confirmation of the charge. In addition, charges other than those listed above are also conditional pending confirmation of the charge with the submission of information, documentation or receipts with 1) description of service or product; 2) date or service or product; 3) amount of service or product.</p>

Situation 1 discloses that an employee may receive benefits under the FSA or HRA even without using the debit card upon submission of either an Explanation of Benefits (EOB) from the health insurance provider or a receipt from a merchant or service provider. Either the employer will pay the merchant or service provider directly after receiving the

EOB or receipt or the employee may pay the expense and subsequently submit a claim for reimbursement with supporting documentation.

In addition, Situation 1 recognizes that, on occasion, claims that do not qualify will be reimbursed. To protect itself in such an event, the employer should adopt appropriate provisions in the FSA and HRA plan documents. The provisions will require that: 1) an employee must reimburse the plan in the amount of the improper payment; or 2) the employer will withhold the amount of the improper payment from the employee's compensation; or 3) the employer may utilize a claims substitution or offset approach with subsequent claims; or 4) the employer could take appropriate actions to avoid future violations of the terms of the card.

**SITUATION 2 - Debit/"Stored Value" Card where substantiation of all claims is not required
(Note: Does not meet the requirements of §105(b)).**

Major Medical Plan with a fixed co-pay amount; FSA and/or HRA	Debit/"Stored Value" Card Provisions	Electronic reimbursement of medical expenses in conjunction with the FSA and HRA	Substantiating a claim under the FSA or HRA plans
<p>FSA: Contributions are paid pursuant to salary reduction elections under a cafeteria plan.</p> <p>HRA: Employer paid; there are no salary reduction elections. The Plan provides that the HRA is available only after expenses exceeding the dollar amount under the FSA has been paid from the FSA.</p>	<ul style="list-style-type: none"> • Uninsured medical expenses are reimbursed up to a maximum reimbursement amount, determined at the beginning of each year. • Cardholder's use of the card is limited to the maximum dollar amount of coverage available in the cardholder's FSA or HRA. • Card may only be used at merchants and service providers authorized by employer (specified physicians, pharmacies, dentists, vision care offices, hospitals, etc.) • When card is used at point-of-sale, merchant/service provider is paid full amount and card is reduced by the same amount. • The cardholder understands that the card will be automatically cancelled when the employee terminates employment. 	<ul style="list-style-type: none"> • Participating employees are issued a card, and certify upon enrollment in the FSA and/or HRA and each plan year thereafter that: <ul style="list-style-type: none"> 1.–the card will only be used for eligible medical care expenses (or IRC §213(d) of employee, employee's spouse and dependents. 2.–any expense paid with the card has not been reimbursed and the employee will not seek reimbursement under any other plan covering health benefits. 3.–the employee understands the certifications are reaffirmed each time the card is used. • The cardholder agrees to acquire and retain sufficient documentation (including invoices and receipts) for any expense paid with the card. 	<p>Sampling Based on Transaction Amounts</p> <ul style="list-style-type: none"> • Employer samples transactions depending on type and amounts owed. For example, the employer will review a certain percentage of a type of transaction that are paid with a card but not otherwise substantiated. • Employer does not review any card transaction below a low-dollar threshold. • Employer does not review any card transaction where the transaction amount is a multiple of a specified whole-dollar amount (e.g., \$5, \$10, 15, etc.), assuming that the transactions are co-payments.

Under Situation 2, the employer does not substantiate all reimbursements made through the card. The employer will require substantiation of only transactions that fit within the parameters of review. Then, if a transaction is selected for review, the employee must submit receipts from a merchant or service provider before receiving benefits under the FSA or HRA.

**SITUATION 3 - Credit card where substantiation of all claims is required
(Note: Meets the requirements of §105(b)).**

Major Medical Plan with a fixed co-pay amount; FSA and/or HRA	Credit Card Provisions	Reimbursement Details	Substantiating a claim under the FSA or HRA plans
<p>FSA: Contributions are paid pursuant to salary reduction elections under a cafeteria plan.</p> <p>HRA: Employer paid; there are no salary reduction elections. The Plan provides that the HRA is available only after expenses exceeding the dollar amount under the FSA has been paid from the FSA.</p>	<ul style="list-style-type: none"> • A sponsoring bank issues a credit card to each participating employee. • Individual limits on each credit card equal the coverage available in the FSA or HRA. • Credit card may only be used at merchants and service providers authorized by employer (specified physicians, pharmacies, dentists, vision care offices, hospitals, etc. that have a "Merchant Code") 	<ul style="list-style-type: none"> • Each employees must certify upon enrollment that 1) the card will only be used for eligible medical care expenses; and 2) any medical expense paid with the card has not been reimbursed; and 3) the employee will not seek reimbursement under any other plan covering health benefits. • Employer agrees to be liable to the sponsoring bank for all charges made with a credit card against the line of credit. • When the credit card is used at the point-of-sale, the sponsoring bank pays the merchant/service provider the full amount of the charge. The employer then repays the bank. • If the claim is denied or inadequate substantiation is presented, the employer will repay the bank but the employee is liable to the employer for the amount of the transaction. 	<ul style="list-style-type: none"> • Co-Payments: If the dollar amount of the transaction at a health care provider equals the dollar amount of the co-payment for the service under the major medical plan for a specific employee, the charge is fully substantiated and there is no need to submit a receipt. • Recurring Expenses: If the expense is for a "recurring expense" for the same amount, provider, and length of time (i.e. a prescription) no further submission of receipts is required after an initial authorization. • "Real-Time Substantiation": If a merchant, service provider or independent third party (i.e. Pharmacy Benefit Manager) verifies the medical expense information at the time and point of charge no further substantiation is required if the information provided matches the amount of the transaction. <p>These are all conditional pending confirmation of the charge. In addition, charges other than those listed above are also conditional pending confirmation of the charge with the submission of information, documentation or receipts with 1) description of service or product; 2) date or service or product; 3) amount of service or product.</p>

As under the fact pattern in Situation 1, under Situation 3 employees may receive benefits under the FSA or HRA even without using the credit card by submitting either an Explanation of Benefits (EOB) from the health insurance provider or a receipt from a merchant or service provider. In such an event, either the employer will pay the merchant or service provider directly after receiving the EOB or receipt or the employee may pay the expense and subsequently submit a claim for reimbursement with supporting documentation.

Under Situation 3, as earlier presented in Situation 1 the employer has adopted provisions in the FSA and HRA plan documents to prevent claims that do not qualify from being reimbursed. The provisions will require that: 1) an employee must reimburse the plan in the amount of the improper payment; or 2) the employer will withhold the amount of the improper payment from the employee's compensation; or 3) the employer may utilize a claims substitution or offset approach with subsequent claims; or 4) the employer could take appropriate actions to avoid future violations of the terms of the card.

Significance of Substantiation - Satisfying §105(b)

Employer-provided expense reimbursement may be excluded from gross income under IRC Section 105(b) (Amounts Received Under Accident and Health Plans) if received by an employee through accident or health insurance. Therefore, it is important that employers can demonstrate that their FSA or HRA plans are reimbursement programs.

The reimbursement methods outlined in Situation 1 and in Situation 3 meet the requirements set forth in IRC Section 105(b), while the method for reimbursement under Situation 2 does not. Under both Situation 1 and Situation 3 all expenses must be substantiated. Specifically that: 1) a certification is required upon enrollment and a reaffirmation is made upon each use of the card, and the card will only be used for eligible medical care expenses; 2) only medical expenses incurred with vendors having health care related "Merchant Codes" will be reimbursed; 3) every claim for reimbursement will be reviewed and substantiated; and 4) correction procedures for claims that are impermissibly reimbursed have been adopted. Situation 1 and Situation 3 must be contrasted against the reimbursement method shown in Situation 2, where only certain payments will be selected for review and substantiation.

Unless all employer-provided expense reimbursements made through debit cards or credit cards (or other electronic media) are fully substantiated, the reimbursements may not be excluded from gross income under IRC Section 105(b). This is significant. Under the plans described in Situation 1 and in Situation 3, payments made to reimburse medical expenses will not be included in the gross income of employees. However, because the procedure in Situation 2 does not meet the requirements of IRC Section 105(b) all payments under the plan will be included in the gross income of employees, defeating an employer's intent to provide the most beneficial arrangements.

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