



New IRS Guidance on Debit Card Use

Many employers have been taking greater advantage of the debit card technology that is available on some Flexible Spending Accounts (FSA) and Health Reimbursement Arrangements (HRA). The debit card feature can serve as a tool to increase employee participation in an FSA and increase satisfaction with an HRA since the card allows for “first-dollar” coverage of certain healthcare expenses without the need to pay out-of-pocket and later seek reimbursement.

Back in 2003, the IRS provided some initial guidance on the use of debit cards in FSA and HRA plans. This guidance provided plans with a several ways to “auto-substantiate” claims when using a debit card. *Auto-substantiation is the ability to verify a purchase as a legitimate expense at the point of sale, rather than requiring the employee to later fax or mail a paper receipt to the plan administrator.* The 2003 IRS guidance allowed plans to auto-substantiate claims at the following times:

1. When expenses at a healthcare provider match a copay for the service (copays amounts such Rx and office visits are programmed into the employee’s card);
2. When expenses are reoccurring (same amount, same provider, same time frame);
3. When expenses are substantiated “real time” at the point of sale (via phone, email or internet).

The IRS has now **expanded** the ways in which claims can be auto-substantiated and clarified some outstanding issues regarding the use of debit cards.

Multiple copayments

Employees using a debit card can make purchases at a healthcare provider without later submitting a receipt when the total is an exact multiple of their plan’s copay. For example, an employee with a three-tiered \$10/\$25/\$40 drug plan can use their card to purchase prescriptions in *any multiple* of the three copays, up to a max of fives times the highest copay amount (\$200).

However, the employee’s purchase could NOT be auto-substantiated if the prescription purchase was combined with an amount that did not match the copay. For example, the employee could purchase two generic drugs at \$10 each and one brand name drug at \$25 and have the transaction auto-substantiated, but if they also purchased cough medicine at \$7.50, they would later need to submit a receipt to their plan administrator. The debit card could still be used for the purchase, but the transaction would be treated as a pending approval until the receipt was submitted.

Using debit cards at non-healthcare merchants

The IRS has officially approved the use of auto-substantiation even at non-healthcare merchants. Previously, debit cards could be used at healthcare

merchants such as pharmacies and physician offices without the need to later submit receipts. Now, the IRS has approved auto-substantiation at *non-healthcare vendors* as long as an Inventory Information Approval System (IIAS) is used. An IIAS assigns a unique stock keeping unit (SKU number) to each item. At the time of purchase, the merchant compares the item's SKU against a list of approved medical expenses. The debit card will then only process the amount associated with eligible purchases. If the transaction is only partially approved, the employee must make a "split-tender" transaction. For example, an employee purchases \$25 worth of over-the-counter pain relief medicine and \$10 worth of shampoo. The \$25 in pain relief purchases would be read by the IIAS as eligible and the shampoo would not. The employee can charge \$25 to their debit card and must submit another form of payment for the \$10 shampoo purchase. Plans using an IIAS after January 1, 2007 are responsible for ensuring that the system meets the IRS requirements.

Explanation of Benefits (EOB) used for claims substantiation

The IRS has also clarified that employees may use an Explanation of Benefits (EOB) as an acceptable form of substantiation to the plan administrator. No additional documentation is required alongside the EOB.

No employee self-certification

Some plans have allowed employees to self-certify their expenses under an FSA or HRA plan by simply providing the date, cost and nature of service. The IRS has expressly prohibited this practice and requires that some third party documentation be presented to the administrator in order to approve a claim for reimbursement (such as an EOB or other receipt).

Dependent Care Assistance Plans (DCAP)

Lastly, the recent guidance has clarified that debit cards can also be used for DCAP plans to pay for childcare services, but only after the service has been rendered. Debit cards cannot be used to pay for childcare services in advance. For example, an employee makes a \$5,000 DCAP election (\$96 week). If the provider accepts payments at the end of each week, the employee can use their card to pay \$96 at the end of each week. If the amount owed to the childcare provider is more than \$96, the employee would have to pay the balance using other means. Once the initial \$96 transaction was substantiated to the plan administrator, each subsequent transaction to the same provider for the same amount could be auto-substantiated and the employee would not need to submit further receipts.

Effective Date

Plans who adopt a debit card with the technology to interface with an IIAS system will have until January 1, 2007 to ensure that the system meets the IRS recordkeeping requirements. All other changes and clarifications immediately impact all FSA and HRA plans with a debit card feature.

For more details regarding this new guidance or how this greater flexibility in using debit cards can benefit your employees, please contact your RSI Benefit Consultant.

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