

Warning!! IRS Seeks to Audit for Debit Card Compliance

As reported in the October 24, 2006 SPBA Email Alert, Harry Beker, IRS Chief of the Health and Welfare Branch, Office of Associate Chief Counsel, has urged employers during a number of recent public appearances to comply with the IRS debit card guidance (IRS Notice 2006-69). SPBA learned from IRS' Elizabeth Purcell, who works closely with Harry, that IRS is actively seeking to audit an entity for compliance with the debit card rules. Vendors selling debit card services will not be audited; instead, employers sponsoring plans with debit cards are in the line of fire. TPAs and their clients need to ensure that their debit cards are in compliance with IRS Notice 2006-69. Be vigilant for debit card vendors that are engaging in creative or wishful interpretations of the IRS debit card rules.

Below we highlight some key points in the debit card guidance that will help you evaluate your plans' debit cards.

IRS Notice 2006-69 creates one set of rules for health care provider merchants (i.e., physicians, pharmacies, dentists, vision care offices, hospitals, and other medical care providers) and another set of rules for non-health care provider merchants (i.e., those that do not have a health care provider merchant code).

Non-Health Care Provider Merchants

Determining whether a merchant is a health care provider is straightforward. If a merchant does not have a health care merchant category code, then the merchant is not a health care provider merchant. A grocery store or a retail discount store that does not have a health care merchant category code is NOT a health care provider merchant. Although a grocery or retail discount store has a pharmacy, this does not mean that the store has a health care merchant category code.

Debit cards must NOT be used at non-health care provider merchants that lack an "inventory information approval system" (explained below). Plan participants should NOT be permitted to use a debit card at these merchants even if the plan participants follow up with receipts to the plan documenting the purchase of medical expense items. In a conversation with Harry

Beker, SPBA was told that substantiation after-the-fact is NOT permitted at non-health care provider merchants that lack an "inventory information approval system."

Debit cards may be used at non-health care provider merchants that have an "inventory information approval system." SPBA understands at the current time that very few grocery stores and retail discount stores have such systems. These systems ensure that only medical care expenses are purchased with debit cards. IRS envisions the "inventory information approval system" to work as follows. When an employee uses the card, the merchant's system collects information about the items purchased using the inventory control information (e.g., SKUs), and the system compares the inventory control information for the items purchased against a list of items that qualify as medical expenses under § 213(d) (including nonprescription medications that are medical-purpose-only items and are not for general health or cosmetic reasons). The qualified §213(d) medical expenses are totaled and the merchant's or payment card processor's system approves the use of the card only for the amount of the §213(d) medical expenses subject to coverage under the plan. If the transaction is only partially approved, the employee is required to pay for the non-approved amounts – IRS refers to this as a "split-tender transaction."

Card transactions using an "inventory information approval system," are considered fully substantiated without the need for submission of a receipt by the employee or further review by the plan. However, plan participants should retain sufficient documentation in the event of an IRS audit.

Health Care Provider Merchants

The IRS guidance permits a debit card to be used at health care provider merchants for conditional transactions and non-conditional transactions. A transaction is conditional when the transaction amount fails to satisfy one of the copayment match methods set forth in the IRS guidance (explained below). If a transaction is conditional, the guidance requires after-the-fact substantiation. In this case, the plan must require the plan participant to forward receipts to the plan, substantiating that the conditional debit card amount was for a medical expense.

A transaction is not conditional when it satisfies one of the copayment match methods set forth in the IRS guidance. A non-conditional transaction does not

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require substantiation after-the-fact. However, Harry Beker noted that the plan must require plan participants to retain sufficient documentation in the event of an IRS audit.

Copayment Match Methods Permissible at Health Care Provider Merchants

>> The dollar amount of the transaction at a health care provider equals the dollar amount of the copayment for that service under the major medical plan of the plan participant.

>> The dollar amount of the transaction at a health care provider equals an exact multiple of not more than five times the dollar amount of the copayment for the service under the health plan.

>> If a health plan has multiple copayments for the same benefits (e.g., a pharmacy benefit with different copayments for generic and non-generic drugs), exact matches of multiples or combinations of copayments will be considered fully substantiated, provided the transaction amount does not exceed five times the maximum copayment for the item or service.

IRS Notice 2006-69 was reviewed in the August 1, 2006 SPBA UPDATE and the article, with some clarifications, is available on the SPBA members-only website, under Hot Issues. The actual IRS Notice 2006-69 is also located on the SPBA members-only website, under Legislative and Regulatory, IRS.