



# *Benefits Briefing*

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***June 5, 2003 Issue # 4***

## ***Editor's Note***

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In an effort to keep you informed of regulation issues and new developments, we will be sending quarterly issues of our newsletter, **Benefits Briefing**. If there are HR contacts at your company who would benefit from this, please give us their names and email addresses, and we will add them to the distribution list.

## **IRS Issues Guidance on Debit/Credit Card Usage for FSA Administration**

After releasing a draft on May 6, 2003, the IRS published Internal Revenue Ruling 2003-21 in the Federal Register dated May 27, 2003 issuing guidance on the use of Debit and Credit Cards in the administration of Health Care Reimbursement Accounts and Health Reimbursement Arrangements (HRAs) for expenses covered under Section 105 of the Internal Revenue Code. The Ruling did not address the use of cards for administration of Dependent Care or Transportation Expense Reimbursement Plans.

On May 28, 2003 Harry Becker, Chief of the Health and Welfare Branch of the IRS, participated in a conference call with members of the Employers Council on Flexible Compensation (ECFC). In that call, Mr. Becker gave ECFC members his insights into the Ruling and further informal, non-binding guidance on the Ruling. The ruling describes 3 situations that are most commonly used by the major marketers of Debit/Credit Card services for FSA Administration. Following are the highlights of the Ruling:

- The use of Cards is acceptable where the participant certifies upon enrollment that the Card will only be used for eligible medical expenses that have not been reimbursed and *reimbursement will not be sought under any other plan*. This is a change from proposed regulations where *is not reimbursable under any other health plan coverage* was used. Mr. Becker indicated he felt that there should be language on the back of each card indicating that the use of the card also certifies the same.
- The use of Cards should be limited to only health and medical care providers identified by the Card System with specific merchant codes.
- **Every claim paid with the Card must be substantiated.** Three types of transactions may be considered automatically substantiated. All others require further manual substantiation. The three types of transactions approved for Automatic Substantiation include:
  - Co-payments equal to specific dollar amounts in the plan the employee is enrolled in. Here, Mr. Becker indicated whole dollar amounts divisible by co-payment amounts would not qualify – only specific amounts equal to co-pays in the specific plan an employee had elected. If an employer offered multiple medical plan options, the amount must be specific to the plan he participates in.
  - Recurring Transactions matching a previously approved and substantiated claim.
  - Real-Time Transactions where the merchant or independent third party (e.g. a pharmacy benefits manager) provides information to verify the charge at the point of sale. This transaction would most commonly be for drug plan co-pays where the Card vendor has interfaces with the PBM to verify eligible claims.

For all other transactions where the Card is used, the employee must file substantiation of the claim similar to current manual processes. This is sometimes referred to as “Pay and Chase” because the employer or administrator must follow-up on these claims. The Ruling provides that reviewing these claims by statistical sampling is not acceptable, but requested comments on

sampling techniques.

- The employer must establish meaningful recovery procedures for non-qualified reimbursements or reimbursements where the employee fails to file proper substantiation. Steps for recovery must include:
  - Requiring repayment of the improper amount by cash or check.
  - Wage withholding where not prohibited by state law.
  - Claim offset against future properly substantiated claims.

The employer must also take actions to ensure future violations do not occur including denying access to the Card. As a last result, the employer must treat the debt as it would any other business debt under its practices. This may result in including the improper amount as taxable income to the employee, but only after other options are exhausted.

- Payments made to medical service providers in excess of \$600 must be reported on Form 1099-MISC under IRS Code Section 6041. Pharmacies and tax-exempt hospitals are exempt from this requirement. This requirement may be particularly problematic because Card vendors are not currently collecting taxpayer identification numbers for providers. Mr. Becker indicated that the IRS had no intention of relaxing this requirement at this time.

### **What does it all mean?**

Card vendors argue that issuing cards increases both the number of participants and the average employee contribution to accounts and therefore increased employer FICA savings. Their marketing statistics suggest that 60% of claims fall under the categories where automatic substantiation applies, while our statistics indicate less than 40% of the numbers of claims and less than 25% of the claims dollars fall under these categories. There are also additional cost of between \$1.25 and \$1.75 per card per month.

At Tri-Star, our concerns include:

- The cost of following up on unsubstantiated claims will more than off set the cost savings from automatically substantiated claims.
- Employee Communication of the substantiation process may be difficult and confusing.
- Employee appreciation of the cash flow convenience may be off set by substantiation follow up (pay and chase) and recovery for improper claims.
- The steps required for recovery of unsubstantiated or improper claims will create an unreasonable burden on employer's staff.
- Systems are not currently able to meet the 1099-MISC reporting requirements.

We will continue to evaluate Card vendor capabilities and the appropriateness of the use of Debit/ Credit Cards for the Plans we administer. If you would like to discuss the use of Cards for you Plan (s) please contact Ken Dixon at 314/985-0284 or 800/727-0182 x 110.

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## New Proposed COBRA Regulations

In the May 28, 2003 Federal Register, the Department of Labor released proposed regulations regarding COBRA notices and disclosures. The new regulations are scheduled to become effective for plan years beginning in 2004. They include safe harbor model forms for the initial **GENERAL NOTICE OF COBRA CONTINUATION COVERAGE RIGHTS** and **COBRA CONTINUATION COVERAGE ELECTION NOTICE** (Qualifying Event Notice).

Also included is guidance on what should be incorporated into Employer notifications to plan administrators of Qualifying Events and rules regarding what kinds of notices employees and qualified beneficiaries may have to provide plan administrators. They include notice of qualifying events (divorce, legal separation, dependent child no longer being covered by the plan.), second qualifying events for extensions up to 36 months, and disability extensions.

Two new notices are specified in the regulations. If an employee or qualified beneficiary notifies the plan administrator of changes beyond the time limit specified by the plan, a “notice of unavailability of continuation coverage” will need to be sent to the individual who is not eligible to continue coverage. They also require plans to provide written notice to qualified beneficiaries receiving COBRA coverage of any early termination of coverage prior to the end of the applicable maximum coverage period (i.e. for non payment of premiums). Most administrators, including Tri-Star, currently issue these notices.

The proposed rules stipulate that COBRA election notices must be “written in a manner calculated to be understood by the average plan participant” and include 15 specified provisions. Those provisions include disclosure of the consequences of failing to elect or exhaust COBRA coverage under HIPAA’s portability, guaranteed access and special enrollment rules.

At Tri-Star, we are reviewing the current notices and procedures for each employer we administer COBRA for, and will be submitting our recommendations for changes to our contacts. The entire text of these new regulations is available at:

<http://www.dol.gov/ebsa/regs/fedreg/proposed/2003013057.pdf>.

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## Child and Dependent Care Tax Credit Increases in 2003

In 2003 the amount of Dependent Care expenses eligible for the tax credit calculation increases from \$2,400 to \$3,000 for one dependent and from \$4,800 to \$6,000 on two or more dependents. The tax credit percentage also increases from 30% to 35% for taxpayers with earned income of \$15,000 or less. The credit percentage decreases 1% for each additional \$2,000 of earned income up to \$43,000 (\$28,000 in 2002 and prior years) where it remains at 20%. The maximum contribution to the Dependent Care Reimbursement Account (DCRA) remains \$5,000 in 2003. Please click on this [website link](#) for worksheet to compare.

In many cases, using the DCRA saves employees more than taking the Tax Credit. Assuming state income taxes of 6% and FICA tax of 7.65%, if the combined earned income of a couple filing jointly or the earned income of a single taxpayer exceeds \$39,000, using the DCRA is more beneficial than taking the tax credit. Additionally, if the taxpayer has only one dependent and eligible expenses exceed \$3,000 the DCRA savings are available on up to \$5,000 of expenses. The attached worksheet can help estimate advantages of the DCRA over taking the tax credit.

### **Helpful Hints:**

If you participate in the DCRA at an amount less than the tax credit limits you can still take a tax credit on the difference. For example, if you contribute \$5,000 to the DCRA and have two eligible dependents in day care with \$6,000 or more in expenses, you can take the tax credit on \$1,000 (\$6,000 tax credit maximum - \$5,000 DCRA contribution).

To take either the tax credit or use the DCRA you must report the name, address, and tax payer identification number of the care provider on IRS Form 2441 and include it with you federal tax return.

If you are married and both spouses are eligible to participate in a Dependent Care Reimbursement Account and one spouse earns more than the FICA limit (\$87,000 in 2003) you would want to consider having the spouse making less than the FICA limit participate in the DCRA.

IRS Publication 503 gives guidance on Child and Dependent Care Expenses and includes a sample Form 2441. At this writing, the IRS **has not** updated it for the 2003 credit increases. The Worksheet on the website link **has been** updated for the credit increases.

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- Debit Card Updates
- Employee Internet Access for FSA Claims Account Information

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