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**August 16, 2006 Issue # 16**

### **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 Debit Card Guidance

On July 11, 2006 the IRS issued Notice 2006-69, which provides additional guidance on the use of debit cards in health FSAs and HRAs. The notice adds guidance to Revenue Ruling 2003-43. The notice provides the additional guidance that includes:

- Assuming the provider/merchant has a health related merchant category code (MCC), exact matches of co-pay multiples of up to five times the maximum co-pay amount may be considered automatically substantiated. See discussion of MCCs in the highlights from the Annual ECFC Administrators Symposium below. For a tiered drug co-pay plan, this could include any matching combinations of co-pays that do not exceed five times the highest co-pay. Drug plans with percentage co-pays are not eligible for co-pay matching and must be substantiated by the Inventory Information Approval System (IIAS) discussed below, by Pharmacy Benefit Manager (PBM), or by submitting receipts after the transaction.
- Inventory Information Approval System (IIAS) is permitted whether or not the MCC is health related. Point of sale systems that match product identification codes to a specific list of eligible

expenses can be considered automatically substantiated. Currently, Walgreens and Drugstore.com have operational systems. The discount and grocery store chains are working diligently with the debit card industry to introduce IIAS in 2007.

- Direct Third Party Substantiation of claims is permitted from health plans and requires no additional review from an administrator. This allows for direct rollover of deductibles and co-pays from the health plan with no additional certification by the employee for payment.
- Dependent Care Expenses may be paid with the debit card only after they are incurred after an initial eligible expense has been substantiated and approved.
- Self-certification of expenses is strictly prohibited.

The full text of Notice 2006-69 is available at: [http://www.irs.gov/irb/2006-31\\_IRB/ar10.html](http://www.irs.gov/irb/2006-31_IRB/ar10.html)

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## IRS Issues Dependent Care Guidance

On May 24, 2006 the IRS issued proposed regulations for the Dependent Care Tax Credit under Code Section 21. Because of the relationship between Code Sections 21 and 129, the proposed regulations also affect the Dependent Care Reimbursement Account (DCRA). The regulations contain some very helpful clarifications of administrative issues that employers may want to communicate to their employees, but will most likely not require changes to plan documents.

Highlights of the proposed regulations (which can be relied upon immediately), include:

- Preschool, nursery school and programs below the kindergarten level are considered care for the qualifying dependent and thus reimbursable from the DCRA
- Kindergarten and higher classes are considered educational and NOT eligible for reimbursement
- Day camps that specialize in a particular activity like soccer or computers are considered to be care and eligible for reimbursement
- Overnight camps are NOT eligible
- Transportation by a care provider to or from the place where care is provided may be reimbursable

- Application and/or agency fees that relate to care are reimbursable IF AND ONLY IF the employee is required to pay the fee to obtain care, IF AND ONLY IF the care is actually provided, and only AFTER the care is actually provided
- No allocation of expenses for days not worked is required for temporary absences like vacation or sick days if the employee is required to pay for care on a weekly, monthly, or annual basis
- No allocation of expenses for part time employment is required for days not worked if the employee is required to pay for care on a weekly, monthly, or annual basis

All of the above highlights assume the expenses are necessary to allow the employee to work or look for work.

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## Highlights from the 19<sup>th</sup> Annual ECFC Flexible Benefits Administrators Symposium

The 19<sup>th</sup> Annual Employers Council on Flexible Compensation Administrators Symposium was held August 9 -11, 2006 at the Fairmont Hotel in Dallas, Texas and attended by more than 300 flexible benefit professionals. The meeting included presentations and discussions from industry leaders and legal experts. It concluded with comments from IRS officials Harry Beker and Elizabeth Purcell on the latest IRS developments. Harry Beker is Chief of the Health and Welfare Branch in the IRS Office of Chief Counsel and Elizabeth Purcell is the Assistant Branch Chief.

Both Mr. Beker and Ms. Purcell expressed frustration with administrators and the debit card industry over their zeal for automatic substantiation of debit card transactions. They indicated that they had gone as far as they felt appropriate in issuing Ruling 2006-69 and that the industry should not look for any more liberalization any time soon. They also indicated that they believed there were administrators out there who were not properly requiring substantiation of debit card transactions or other claims and Harry offered his email address ([harry.beker@irscounsel.treas.gov](mailto:harry.beker@irscounsel.treas.gov)) and phone number (202) 622-6080 for anyone to report perceived abuses.

One point that they seemed unwilling to budge on, was that MCCs (Merchant Category Codes) for grocery or discount stores are NOT health-related categories and do not qualify for the co-pay match automatic substantiation. Auto-substantiation at those type stores (like Wal-Mart or Target) could only be through the IAS (Inventory Information Approval System) or PBM (Pharmacy Benefit Manager). Because approximately 30% of prescriptions are filled at these types of

stores, many administrators have considered them to be health-related categories.

One administrator who conservatively follows the IRS guidance reported that although only about 20% of the participants they administer have debit cards, 80% of the phone calls they get are for card problems and as a result they have increased support staff by 25%. Consensus of the professional administrators attending the conference seemed to be that demand for the debit cards has been created by the industry and that they were here to stay. Development and adoption of the IIAS will dramatically increase automatic substantiation of claims, but it may be well into 2007 or later that the technology is available to most grocery and discount stores.

Mr. Beker also indicated that issuance of new Section 125 Regulations, although originally scheduled to be issued by June 30, 2006, would not be released until late fall or winter of this year.

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## Tri-Star Has Added The **Benny Card** Debit Card

Tri-Star announced in December 2005 that we were adding the Evolution Benefits, Corp. **Benny Card** as another debit card option for processing of FSA claims, beginning in March of 2006. **Benny Card** is one of the nation's leading processors of FSA Debit Card transactions and features state of the art technology for automatic adjudication of pharmacy and medical co-pay claims.

We are happy to announce that this debit card option is up and running. Based on our results so far we expect the **Benny Card** will be our number one recommendation for our valued customers. If you have any questions about adding the debit card option to your benefit plan please don't hesitate to call.

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## IRS Publication Links

With tax season upon us we wanted to provide you with some handy links to IRS Publications that may help you and your employees. We hope they are helpful to you.

[IRS Publication 502 \(Health Care\)](#)

[IRS Publication 503 \(Dependent Care\)](#)

[IRS Publication 969 \(HSAs and Other Tax-Favored Health Plans\)](#)

[IRS Publication 968 \(Adoption\)](#)

[Other IRS Publications](#)

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