



**COBRA**

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## **DEBIT CARD SUBSTANTIATION**

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### **Summary**

Under IRS Revenue Ruling 2003-43, every transaction on an FSA debit card must be either substantiated (electronically or manually) or recouped from the employee. Substantiation can be through either electronic evidence (auto-adjudication) or paper receipts submitted by the user (similar to filing a paper claim). The process of obtaining receipts or recoupment when auto-adjudication is not possible is known as "pay and chase", a term the IRS also used in a recent ruling (Notice 2007-02).

### **Auto-Adjudication Rules**

The most common method of auto-adjudication is known as "copay matching". Under Ruling 2003-43 as amplified by Notice 2006-69, the FSA or HRA provider must obtain from the employee's health plan the standard copayment amounts for that plan. If the charge is exactly equal to between one (1) and five (5) of those copayment amounts, it may be auto-adjudicated and approved without receipts. If the health plan has different copayment amounts for a particular type of charge, any valid combination of copayment amounts may be approved, up to five times the highest possible copayment amount.

Charges may be auto-adjudicated if they are accompanied by electronic information substantiating that the charge is for medical purposes. This may be done through such means as including details of the transaction with the charge (Ruling 2003-43) or forwarding the health plan's explanation of benefits to the FSA or HRA provider for further processing (Notice 2006-69). *Participants should save all receipts, EOB's or itemized bills. A credit card receipt is not acceptable substantiation.*

### **IIAS Compliance**

IIAS is an inventory control system that prevents the use of the debit card for ineligible products and services. Under Notice 2006-69, all charges from a merchant that is IIAS compliant may also be auto-adjudicated; however, beginning in 2007 the merchant must make available to the employer the detailed records of all such transactions for IRS review. This may be done either automatically or in response to an IRS audit of the employer. Service providers like big-box chain stores (Wal-Mart, Target, K-Mart, etc.) and chain pharmacies (CVS, Walgreens, Rite Aid, etc.) are typically IIAS compliant. Many large grocery store chains are also IIAS compliant. Smaller independent stores may not be IIAS compliant.

### **IIAS Non-Compliance**

It is important to note that simply incurring a charge at a medical provider's office is not evidence that the charge is eligible under the terms of the plan. Many providers perform services that might be deemed ineligible under the terms of the plan. There are several examples of this. Dental providers often perform teeth whitening services or install veneers (which are generally not eligible unless the provider certifies that the medical outcome is better than the alternative covered service, like placement of a crown). Vision providers often sell non-prescription sunglasses, which are not eligible under the terms of the plan.

A debit card charge from a provider's office is not in indication that the service provide is covered under the terms of the plan nor is it an indication of your actual patient liability when the charge is not equal to plan recognized copays. Providers often estimate your patient liability, particularly with regard to dental and vision claims. A medical, dental, or vision insurance carrier will process your claim and the Explanation of Benefits (EOB) may reflect a difference patient liability than that which was actually charged on the debit card. Further, the EOB is the best evidence that the charge is accepted under the terms of your plan. We may request the EOB from you to confirm the charge is eligible.

### **Recoupment and Card Suspension**

If the charge is not substantiated by auto-adjudication or receipts, the FSA or HRA provider must recoup the charge

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and suspend the card until it is recouped. In addition to voluntary methods of recoupment, employers commonly use payroll deduction, as well as offsetting the recoupment against future paper claims. If all else fails, the employer may add the amount of the charge to the employee's W-2 as taxable income.

### **Conclusion**

Please note that Continuon Services, LLC will strictly enforce the guidelines above and any and all future guidance from the Internal Revenue Service (or other applicable government agencies) and our legal counsel. Our objective is to comply with all laws and governmental agency advice and to maintain the integrity of the plan for the future benefit of our client's plan participants. Non-compliance may result in certain penalties to the employer.

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Examples:

**Example 1:** Mike goes to his dentist and pays \$272 for his portion of the expense for a root canal with his FSA debit card. The purchase amount does not match any known plan co-pay, and it cannot be electronically substantiated. Two days after Mike makes the purchase, he receives an email from Continuon Services asking for supporting documentation to ensure that his purchase was eligible for a tax break. Mike faxes his statement from his dentist or an Explanation of Benefits (EOB) and the charge is cleared. His debit card is not deactivated because he responds in a timely manner.

**Example 2:** Bob goes to the local vision center store and purchases glasses that cost \$145 for his child with his FSA debit card. Two days later, Bob receives an email from Continuon Services asking for supporting documentation to ensure that the purchase was eligible for a tax break. Bob doesn't immediately follow-up with the documentation, thinking he will provide this information at the end of the month. However, Bob does not send the information at the end of the month (he forgets to do so). His debit card is deactivated. Bob later submits a claim for \$25 in over-the-counter medication he paid for with cash. Continuon Services processes the claim and his account shows as being over-reimbursed by \$120 (the difference between the denied claim of \$145 and the eligible claim of \$25). Bob finally remembers to submit the itemized statement or EOB from his vision provider. Continuon Services processes the claim and issues a reimbursement for \$25 (for the OTC medication he paid for with cash). His card is reactivated.

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