

New ruling enhances flexible spending accounts and health reimbursement arrangements

Small businesses are always looking for new ways to cut costs while continuing to provide quality health benefits. The IRS recently gave employers a hand by allowing tax-free payments and reimbursements to be made to flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs) via debit or credit cards and other electronic media. Adequate controls must be in place to assure that only medical costs are reimbursed. This decision gives employers and employees greater flexibility and increases the attractiveness of FSAs and HRAs, especially at a time when health care costs are straining the resources of many small employers.

Two scenarios

The IRS examined two reimbursement arrangements under which payments were excluded from the employee's gross income.

In the first situation, employees were issued a debit or credit card to use for medical care expenses at employer-authorized service providers. However, the card also could be used to pay for treatment and equipment at non-employer authorized service providers. In the second situation, credit cards were issued to employees with a limit equal to the coverage available under the health plan. Employees could use the cards only at employer-authorized service providers.

Special attributes

In both situations, the IRS explained that it would consider the charges on the credit or debt card as fully substantiated medical expenses and excludable from employees' gross incomes. The arrangements must have the following attributes, including:

- The employee keeps receipts or documentation for expenses paid with the card.
- The transaction dollar limit equals the co-payment for that service.
- Recurring expenses match previously approved expenses as to amount, provider, and time period.
- Pre-authorization for additional charges for treatment at a physician's office.

Adequate controls

The IRS cautioned that small businesses must have adequate procedures for identifying improper payments as well as requiring employees to pay back any improper charges.

Please contact this office if you wish to explore how an HRA now can help you cut benefit costs while providing your employees with an FSA-backed payment card as a convenient way to cover their medical costs.