

## NEWS ALERT

### EMPLOYEE BENEFITS



## IRS Releases Information Letters on Substantiation Rules for Health FSA Debit Cards

By Melanie N. Aska and Ere M. Sharp | August 24, 2021

The IRS recently released two Information Letters addressing the substantiation rules that apply to health flexible spending account (FSA) debit cards. (As an aside, IRS Information Letters call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. Thus, although IRS Information Letters do not break new legal ground, they often provide helpful reminders about legal requirements that should be front-of-mind.)

One IRS Information Letter, Number 2021-0003 (released on June 25, 2021, [see https://www.irs.gov/pub/irs-wd/21-0003.pdf](https://www.irs.gov/pub/irs-wd/21-0003.pdf)) responded to an inquiry sent by a U.S. Senator on behalf of a constituent whose wife's health FSA debit card was deactivated when she did not provide documentation, requested by the plan administrator, to substantiate medical expenses paid with a debit card linked to a health FSA under an Internal Revenue Code Section 125 cafeteria plan.

The other IRS Information Letter, Number 2021-0013 (also released on June 25, 2021, [see https://www.irs.gov/pub/irs-wd/21-0013.pdf](https://www.irs.gov/pub/irs-wd/21-0013.pdf)) responded to requests for general information about the substantiation rules that apply to health FSA debit card transactions.

The IRS Information Letters explain that medical expenses paid or reimbursed from a health FSA are excludable from the participant's federal gross income and must be verified by an independent third party (independent of the participant and his or her spouse and dependents, that is) who substantiates the expenses. Independent third-party substantiation for medical expenses includes (1) information describing the service or product, (2) the date of the service or sale, and (3) the amount of the expense.

Special substantiation rules apply to medical expenses paid or reimbursed with a health FSA debit card. These rules take into account the information a debit card transaction provides. Some debit card transactions require additional information to fully substantiate that the expense is a medical expense. For example, a debit card transaction may collect information about the amount of the transaction, a general category of the merchant providing services, and the specific merchant providing the services, but may not identify the specific items or services provided in the transaction. If the information provided during the debit card transaction does not satisfy the substantiation requirements, the plan administrator must request additional information to substantiate the medical expense. The plan administrator must deactivate the debit card if the medical expense is not timely substantiated.

There is a deep downside to failing to provide adequate independent third party substantiation of health FSA medical expenses paid or reimbursed through use of a debit card or otherwise: any substantiation failure will cause *all* amounts paid or reimbursed from the plan to be includible in gross income, including amounts paid or reimbursed for medical expenses, whether or not substantiated.

*If you have questions about health FSA substantiation requirements or how they might affect the health FSA component of your Section 125 cafeteria plan, please contact:*

*Melanie N. Aska, Counsel, at 617-457-4131 or [maska@murthlaw.com](mailto:maska@murthlaw.com)*

*Erek M. Sharp, Partner, at 203-772-7772 or [esharp@murthlaw.com](mailto:esharp@murthlaw.com)*