

# DAVID K. YOUNG, CONSULTING TRENDS

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FOR THE CLIENTS

& FRIENDS OF

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## OVER THE COUNTER DRUGS ARE NOW ELIGIBLE FOR FSA REIMBURSEMENTS

On September 3, 2003, the IRS issued Revenue Ruling 2003-102.

"Flexible Spending Accounts are an important tool in helping people meet their health care costs," stated Treasury Secretary John Snow.

"Since many prescription drugs have moved to the over-the-counter market, this action today makes paying for them a little bit easier to swallow."

This Revenue Ruling changes the IRS position regarding the reimbursement of over-the-counter (OTC) drugs from health care flexible spending accounts (health FSAs) and health reimbursement arrangements

(HRAs). Prior to the ruling the IRS had stated that OTC drugs could not be reimbursed by such plans because reimbursements are limited to expenses that would qualify as deductible medical expenses. IRC §213(b) only permits a deduction for drugs that are "prescribed drugs" or insulin. A "prescribed drug" is a drug that is not available in any form without a prescription. Thus, if a drug can be obtained in any form OTC, then it is not a deductible medical expense under the prior IRS position

The change in the IRS position is the result of a

strict interpretation of IRC §105. IRC §105 which permit an individual to exclude from income any amounts paid by a health plan that are reimbursements of expenses for "medical care." The key to the IRS interpretation is that the statute only refers to "medical care" as defined in IRC §213(d). Under IRC §213, amounts spent for OTC drugs are "medical care" expenses, they just aren't deductible. Because IRC §105 allows the reimbursement of any medical care expenses, not just those that would be deductible, it is permissible for health FSAs and HRAs

*(Continued on page 3)*

## IRS ANNOUNCES PENSION PLAN LIMITATIONS FOR 2004

The Internal Revenue Service announced on October 16th the cost-of-living adjustments applicable to dollar limitations for pension plans and other items for Tax Year 2004.

Many of the pension plan limitations will change for 2004. For most of the limitations, the increase in the cost-of-living index met the statutory thresholds that trigger their adjust-

ment. Furthermore, several limitations, set by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), are scheduled to increase at the beginning of 2004.

*(Continued on page 3)*

## **BENEFIT PROFESSIONALS ARE SEEING AN ALARMING FALL IN RETIREMENT PLAN PARTICIPATION**

According to data just released in the Census Bureau's Current Population Survey (CPS), both the number of workers in the private sector whose employer sponsored a retirement plan and the number of workers who participated in such plans fell again in 2002. The CPS data show that among workers in the private sector between the ages of 25 and 64 who were employed full-time, the number whose employer sponsored a retirement plan fell from 45.1 million in 2001 to 42.8 million in 2002. The number of these workers who participated in an employer-sponsored retirement plan fell from 38.7 million in 2001 to 37.0 million in 2002. The percentage of 25 to 64-year-old, full-time employees in the private sector who participated in an employer-sponsored retirement plan fell from 55.8% in 2001 to 53.5% in 2002. A Congressional Research Service (CRS) analysis of the Cur-

rent Population Survey indicates that, among workers 25 to 64 years old who were employed in the private sector and worked year-round, full-time:

1.) Retirement plan participation has fallen for three consecutive years, declining from 58% in 1999 to 53.5% in 2002. 2.) Only 27.3% of workers at firms with fewer than 25 employees participated in an employer-sponsored retirement plan in 2002, compared to 47.8% of workers at firms with 25 to 99 employees and 66.6% of workers at firms with more than 100 employees. 3.) In 2002, there was relatively little difference in retirement plan participation among men and women in the private sector between the ages of 25 and 64 who worked year-round, full-time; 53.9% of men and 52.9% of women participated in a company-sponsored retirement plan. 3.) In 2002, only 45% of private-sector workers 25 to 34

years old who were employed year-round, full-time participated in an employer-sponsored retirement plan, versus 57% of workers 35 or older. 4.) Black, Hispanic, and other non-white workers were less likely to have worked for an employer that sponsored a retirement plan, and therefore were less likely to have participated in a plan. Fifty-nine percent of white workers in the private sector who were employed year-round, full-time in 2002 were included in a company-sponsored retirement plan, compared to 47.5% of black non-Hispanic workers, 31.1% of Hispanic workers, and 49.2% of other non-white workers. 5.) Workers who earned less than \$20,000 in 2002 were one-third as likely as those who earned \$60,000 or more to have participated in a retirement plan at work. 6.) Part-year or part-time workers in the private sector were half as likely to have participated in an employer-sponsored retirement plan.

## **HEALTH FSA AND HRA DEBIT CARDS MAY NOT HAVE TO REPORT ON 1099 AFTER ALL**

Many of our clients have begun to convert over to the use of debit cards in recent months, or plan to do so with their new plan years starting in 2004. One point of interest that we have been tracking for our clients has been the Treasury Department's proposed requirement that plan administrators report medical expenses paid on Form 1099. This is typically done for self-insured Section 105 plans. However, many practitioners have argued that the require-

ment will be hard to meet with FSAs because of the nature of payments from FSAs.

The Treasury Department has released two letters indicating that it is reconsidering the issue of whether reporting on Form 1099 is required for payments to health care providers with debit cards under health FSAs and HRAs. The letters are virtually identical and respond to letters to Treasury expressing concern about Form 1099 reporting for health FSA and HRA debit cards.

In the letters, Treasury says it recognizes that many companies sponsoring such cards did not anticipate that making the payments directly to providers would result in the application of the reporting requirements. The letters also indicate that Treasury is aware that employers are likely to be unable to satisfy the Form 1099 reporting requirements at this time because generally they do not have access to (and will not be provided with) provider taxpayer identification numbers."

## IRS Releases Revenue Ruling 2003-102 Concerning OTC Medications.....CONTINUED FROM PAGE 1

to reimburse OTC drugs.

Because the response to this IRS change in position has generally been favorable, David K. Young, Consulting (DKY) will begin reimbursing via FSAs for OTC medical expenses. While all claims must be substantiated, presumably the substantiation of an expense for OTC drugs would be handled in the same manner as any other expense. For example, where there is no Explanation of Benefits from a health plan, DKY requires proof that the expense was incurred plus a certification from the individual that the expense

was for medical care via a claim form and is not otherwise reimbursable by other coverage. There is no reason to presume that OTC drugs need to be handled any differently in DKY's claim procedures.

Some practitioners have questioned whether a change in benefit elections can be made due to the new IRS position. Proposed Regulation 1.125-4(f) provides that participants in a health FSA offered through a cafeteria plan cannot change elections for the health FSA due to cost or coverage changes. Therefore, DKY will

not allow mid-year election changes for health FSAs as a result of the Revenue Ruling.

DKY will be updating plan documents in the near future to reflect the current IRS ruling, bringing the plan language up-to-date. The restatement of the plan document will also include updating the documents to reflect HIPAA language requirements as well as new claim procedure requirements. In addition, if you company has been using a SPD or other materials that exclude OTC, those should be updated too.

## Pension Plan Limitations for 2004.....CONTINUED FROM PAGE 1

For example, under EGTRRA, the limitation under section 402(g)(1) on the exclusion for elective deferrals described in section 402(g)(3) is increased from \$12,000 to \$13,000. This limitation affects elective deferrals to section 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

The contribution limitation (from all sources) per participant for defined contribution plans is increased from \$40,000 to \$41,000. With the addition of catch-up contributions that were also increased to \$3,000, an age 50 or older participant can now have contributions from all sources add up to \$44,000.

Annual contribution limits for SIMPLE Plans has now been increased from \$8,000 to \$9,000.

Catch-up contributions for SIMPLE Plans has been increased from \$1,000 to \$1,500.

The annual compensation limit that can be considered for pension plan contributions has now been increased from \$200,000 to \$205,000. This limit prevents high income individuals from considering income for deferral above the \$205,000 limit.

The limitation used in the definition of highly compensated employee under Section 414(q)(1)(B) remains unchanged at \$90,000.

SEP minimum compensation is remaining the same at \$450 annually.

Employers that have not done so may have to amend the retirement plans to implement the

limits available under EGTRRA. For plans administered by David K. Young, Consulting that incorporates the relevant tax code sections by reference (i.e., containing language referring to the tax code sections), the increases will automatically take effect.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

Because many of the limits for 2004 change from 2003, retirement plan sponsors should immediately make systems changes to accommodate the increased limits along with updating communications materials.

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## DID YOU KNOW YOU ARE IN A MINEFIELD?

Have you asked yourself lately about all the rules and regulations concerning the management of your human resources and employee benefit programs? You are in a minefield that could destroy you and your company.

Do you have an administration need or questions about your:

- Pension or Retirement Plan
- COBRA Compliance and Administration
- Section 125/Cafeteria Plan
- Workers' Compensation/ERISA Plan
- FMLA Compliance
- ADA Compliance
- FLSA Compliance
- Job Descriptions
- Employee Handbook
- Policy & Procedures...?

David K. Young, Consulting has the answers for these areas & others. Call us at 210-558-0999 or email us at [david@dkyoung.com](mailto:david@dkyoung.com) for answers to your questions.

## MISCELLANEOUS BENEFIT NEWS

### Fees for Health FSA Can Now be Reimbursed via the FSA

The IRS's top cafeteria plans expert, Harry Beker, confirmed that for plans using a debit card, if there was a charge imposed for using the card, it would be okay to take that fee out of the participant's health FSA account. And he commented that it would be permissible to do the same for a traditional (non-debit card) health FSA. Participants would need to be advised in advance that such administration fees will be taken out of their health FSAs with an explanation of how the fees will be calculated (e.g., on a per-transaction basis, fixed or percentage rate, etc.).

### HHS deems FSA/HRA debit cards exempt from HIPAA rules

Further clearing the path for FSA/HRA debit cards to proliferate among employers, the Health Department's Centers for Medicare & Medicaid Services (CMS) announced transactions using the cards are exempt from HIPAA electronic data interchange (EDI) rules. "After a thorough review of the situation, we have determined that a beneficiary's use of the FSA debit card is comparable to using a conventional credit card, and that debit card transactions are not subject to HIPAA EDI requirements," CMS writes.

### ERs Look to Voluntary Products

Twenty-five percent of the nation's employers—an estimated 300,000 companies—are interested in introducing, or expanding their offerings of, voluntary benefits, which are insurance programs that employees pay for but are able to get at lower cost through their workplace. According to LIMRA International, employers also are going beyond the traditional life, accident, and disability programs to offer long-term care insurance (LTCI), critical illness insurance, and Section 529 college savings plans. Among small employers, (10-100 employees), well over half offer at least one voluntary benefit, with many offering three or more.