Just What the Doctor Ordered—IRS Issues Guidance on Over-the-Counter Medicine Reimbursements for FSAs and HRAs

On September 3, 2010, the Internal Revenue Service (IRS) published guidance regarding the use of tax-favored health accounts, such as health flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs), to pay for over-the-counter (OTC) medicines as provided for by the Patient Protection and Affordable Care Act (Affordable Care Act) (P.L. 111-148). The new rules are effective as of January 1, 2011 for all plans, regardless of whether an employer uses an off-cycle (non-calendar year) plan year or has adopted the allowable grace period. The guidance is contained in Notice 2010-59, Revenue Ruling 2010-23, and a series of questions and answers.

Impact on Employers Offering FSAs, HRAs, and HSAs
Employers that sponsor FSAs or HRAs, or offer a high-deductible health plan with an HSA, need to take the following steps to assure compliance with the guidance:

■ Confirm with third-party administrators for FSAs and HRAs, or the trustee/custodian for an HSA, that reimbursement processes and procedures are updated to reflect the change prior to the effective date.

■ Clearly communicate the change to employees so they can consider the change during the annual enrollment process.
  — Update summary plan descriptions and/or issue a summary of material modification in the case of FSAs and HRAs.
  — Update all existing communications that discuss allowable reimbursable expenses under an FSA, HRA, or HSA.
  — Communicate the consequences of using HSA funds for OTC medicines for which the account holder does not have a prescription.

■ Amend the FSA for the change by June 30, 2011 (see the “Cafeteria Plan Amendments” section below) and amend the HRA for the change by December 31, 2010.

OTC Reimbursements Made by FSAs and HRAs Will Require a Prescription
The guidance clarifies that effective January 1, 2011, the cost of OTC medicines cannot be reimbursed by FSAs and HRAs unless the individual has a prescription issued by an authorized individual. The new requirement does not apply to insulin and other health care expenses, such as OTC supplies (bandages, crutches, etc.), copays, and deductibles.
Debit Card Purchases After January 1, 2011

OTC Medicine Purchases at Merchants That Use an Eligible Items List

Generally, under current rules, a plan may permit the purchase of OTC medicines from merchants that maintain an eligible items list that complies with the inventory information approval system requirements. An OTC medicine purchased from such a merchant does not need to be further substantiated by the plan. Starting January 1, 2011, since OTC medicines will require a proof of prescription, OTC medicines will not be able to be purchased with a debit card from merchants that use an eligible items list. As a result, after the effective date, participants will be required to pay for OTC medicines, and then submit to the plan the receipt along with the prescription for reimbursement.

In order to give merchants sufficient time to make system changes to accommodate the new rules, the IRS will not challenge the use of FSA or HRA debit cards for expenses incurred through January 15, 2011. Consequently, participants in FSAs and HRAs will be able to continue to use their debit cards to purchase OTC medicines from merchants that maintain an eligible items list through January 15, 2011.

OTC Medicine Purchases at 90% Pharmacies

Until further guidance is issued, debit cards may be continue to be used at a pharmacy that satisfies the 90% test to purchase OTC medicines that have been prescribed, provided proper substantiation is submitted to the plan. A pharmacy satisfies the 90% test if the pharmacy can demonstrate that 90% of its gross receipts for the prior year consisted of items that qualify as medical care. For purposes of determining whether a pharmacy meets the 90% test, sales of OTC medicines at the pharmacy may continue to be taken into account after December 31, 2010.

Other Debit Card Purchases

In other respects, the debit card may continue to be used in the same manner as it is currently used. For example, OTC health supplies such as bandages and crutches can continue to be purchased with the debit card if the items qualify as medical care. In addition, participants will continue to be able to use their debit card for copayments or coinsurance for medicines or drugs requiring a prescription or insulin, as well as for other allowable copayments and coinsurance amounts for medical services.

Reimbursement for OTC Medicines and Drugs Through FSAs or HRAs

The following chart summarizes the requirements to obtain reimbursement through an FSA or HRA for OTC medicines and drugs beginning January 1, 2011.

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<thead>
<tr>
<th>Reimbursable for Associated Expenses Incurred Before January 1, 2011</th>
<th>Reimbursable for Associated Expenses Incurred On or After January 1, 2011</th>
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<tr>
<td>■ Medicines or drugs requiring a prescription</td>
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<td>■ OTC medicines</td>
<td>■ OTC medicines with a prescription</td>
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<td>■ Insulin</td>
<td>■ Insulin</td>
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<tr>
<td>■ Debit card can be used for OTC medicine purchases</td>
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<td>■ Debit card can be used for OTC medical supplies that qualify as medical care</td>
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<td>■ Copayments and deductibles</td>
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Reimbursement Rules for HSAs
The guidance clarifies that a distribution after the effective date under an HSA for an OTC medicine or a drug is tax free only if the account holder obtains a prescription. If amounts are distributed under an HSA for an OTC medicine or drug for which the account holder does not have a prescription, the distribution will be taxable and will be subject to a 20% additional tax.

Cafeteria Plan Amendments
While cafeteria plan amendments may generally only apply prospectively, the IRS guidance provides that a conforming amendment made no later than June 30, 2011 may be effective retroactively for OTC medicine expenses incurred after December 31, 2010 (or after January 15, 2011 for debit card purchases).

More Information


Questions and Answers published by the IRS are available at: http://www.irs.gov/newsroom/article/0,,id=227308,00.html