



UPDATE Employee Benefits and Compensation

SEPTEMBER 2010

IRS Issues Guidance on Reimbursement for Over-the-Counter Medications

Recently, the Internal Revenue Service (IRS) issued guidance concerning the reimbursement or payment for certain medications and medical equipment from tax-favored health accounts. These new rules are relevant to all employers sponsoring group health plans, such as health flexible spending arrangements (health FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs), and Archer Medical Savings Accounts (Archer MSAs), that currently reimburse expenses for over-the-counter (OTC) medications. The new rules are contained in IRS Notice 2010-59 (Notice).

REIMBURSING OVER-THE-COUNTER MEDICINES

The [Patient Protection and Affordable Care Act](#) established a new uniform standard for medical expenses to be eligible for reimbursement or payment. Under new Section 106(f) of the Internal Revenue Code (Code), expenses incurred for medicines or drugs may be paid or reimbursed by health FSAs, HRAs, HSAs, and Archer MSAs only if (1) the medicine or drug requires a prescription or (2) the medicine or drug is available without a prescription but the individual otherwise obtains a prescription. The new restrictions apply only to purchases made on or after January 1, 2011. Claims for medicines or drugs purchased without a prescription in 2010 can still be reimbursed in 2011 if permissible under the applicable plan.

This new restriction does not apply to reimbursements for the cost of insulin, even if purchased without a prescription, nor to items for medical care. For example, equipment, supplies (e.g., bandages), and diagnostic devices will still qualify for reimbursement or payment by a health FSA, HRA, HSA, or Archer MSA regardless of whether the items are purchased using a prescription. Notably, the Notice expressly states that "such items may qualify as medical care if they otherwise meet the definition of medical care in [Code Section] 213(d)(1)" but warns that "expenses for items that are merely beneficial to the general health of an individual . . . are not expenses for medical care."

THE USE OF HEALTH FSA AND HRA DEBIT CARDS

According to the Notice, health FSA and HRA debit cards will need to be reprogrammed because they are incapable of recognizing and substantiating whether medicines or drugs are prescribed.

Recognizing the significant efforts required to change existing debit card systems to comply with the new standard, the IRS will not challenge the use of health FSA and HRA debit cards for expenses incurred through January 15, 2011, if the use of such debit cards is otherwise compliant with applicable regulations.

PLAN AMENDMENTS

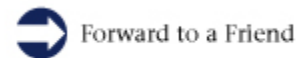
Plan sponsors may need to amend their cafeteria plans to conform to the new restrictions applicable to medical expenses. Notwithstanding the rule against retroactive amendments, the Notice permits an amendment to conform a cafeteria plan to the new requirements if adopted no later than June 30, 2011. The amendment may be made effective retroactively for expenses incurred after December 31, 2010 (or after January 15, 2011, for health FSA and HRA debit card purchases).

If you have any questions about these changes and how they affect your cafeteria plan, please contact any of the following attorneys:

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