IRS Provides Guidance Regarding Over-the-counter Medicines

The IRS recently released Notice 2010-59 (the Notice) which clarifies new rules regarding the reimbursement of over-the-counter (OTC) medicines and drugs that were introduced in Section 9003 of the Patient Protection and Affordable Care Act of 2010 (PPACA). The IRS also issued an FAQ, which you can find at http://www.irs.gov/newsroom/article/0,,id=227308,00.html.

Section 9003 of PPACA indicates that expenses incurred on or after January 1, 2011 for medicines and drugs may be paid or reimbursed by an employer-sponsored accident and health plan, including health flexible spending accounts (FSA) and health reimbursement arrangements (HRA), only if the medicine or drug is prescribed by a physician (determined without regard to whether such drug is available without a prescription), or is insulin.

NOTE: These same rules apply to health savings accounts and Archer medical savings accounts, even though they are not employer-sponsored accident and health plans.

The Notice clarifies that for the purpose of OTC expenses, a prescription means “a written or electronic order for a medicine or drug that meets the legal requirements of a prescription in the state in which the medical expense is incurred and that is issued by an individual who is legally authorized to issue a prescription in that state.”

These rules do not apply to OTC items that are not medicines or drugs, including but not limited to equipment (such as crutches), supplies (such as bandages), and diagnostic devices (such as blood sugar test kits). Such items may qualify for reimbursement under a health FSA or HRA if they otherwise meet the definition of medical care in Code Section 213(d).

Substantiating an Expense

The Notice clarifies that an OTC expense can be substantiated by submitting the prescription (or a copy of the prescription or other documentation that a prescription has been issued) for the over-the-counter medicine or drug, and other information from an independent third party that satisfies the requirements under Prop. Treas. Reg. § 1.125-6(b)(3)(i). Thus, for example, a customer receipt issued by a pharmacy which identifies the name of the purchaser (or the name of the person for whom the prescription applies), the date and amount of the purchase, and an Rx number satisfies the substantiation requirements for over-the-counter medicines or drugs, as does a receipt without an Rx number accompanied by a copy of the related prescription.

Debit Cards

Generally, health FSA and HRA debit cards may not be used to purchase OTC drugs beginning January 1, 2011. However, the IRS has indicated that they will not challenge the use of debit cards to pay for OTC medicines or drugs through January 15, 2011, as long as the use of the card adheres to all other applicable rules for such use.

In addition, the Notice allows health FSA and HRA debit cards to continue to be used to purchase OTC drugs at pharmacies that satisfy the 90 percent test in Notice 2007-2 until further guidance is issued. If a debit card is used in this manner, the participant must submit the required substantiation identified above.
Effective Date
The prescription requirement applies to OTC medicines and drugs purchased on or after January 1, 2011. This effective date applies to all plans, regardless of the plan year dates. This means that the rules will change in the middle of the plan year for all plans that are not calendar year plans (i.e., a plan year that begins on January 1 and ends on December 31).

OTC drugs purchased in 2010 but submitted for reimbursement in 2011 (to the extent permitted) do not require a prescription.

For health FSAs that offer the 2.5-month grace period feature, OTC drugs incurred in 2011 can be reimbursed from 2010 account balances only if the participant obtains a prescription for those items as described in this flash.

Plan Amendments
The Notice includes a special provision that allows plan sponsors until June 30, 2011, to make any plan document amendments required by these new rules. These amendments may be effective retroactively for expenses incurred after December 31, 2010 (or, with respect to debit cards, expenses incurred after January 15, 2011).

Additional Information
The full text of the Notice is available online at www.irs.gov/pub/irs-drop/n-10-59.pdf.

CONEXIS is currently reviewing the guidance and will issue additional information regarding updates and changes to our policies and procedures in the near future.