

Client Advisory | November 2010

New Restrictions on Reimbursement for Over-the-Counter Medications Beginning in 2011

The Affordable Care Act¹ imposes new restrictions on the reimbursement of expenses for over-the-counter (OTC) medicines and drugs. Beginning January 1, 2011, expenses for OTC medicines and drugs purchased without a prescription (other than insulin) may no longer be paid or reimbursed from health care flexible spending accounts (“health FSAs”), health reimbursement arrangements (“HRAs”) or other employer-provided group health plans.²



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The IRS recently issued Notice 2010-59 which provides guidance on the implementation of these new restrictions.

Reimbursement Restricted to Prescribed Drugs, Insulin and OTC Drugs that are Prescribed

Expenses incurred after December 31, 2010 for a medicine or drug will be treated as a reimbursement for a “medical expense” only if such medicine or drug (1) requires a prescription, (2) is available without a prescription (i.e., an OTC medicine or drug) and the individual obtains a prescription, or (3) is insulin.

For these purposes, a “prescription” is 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.

Restrictions Do Not Apply to Equipment, Supplies or Diagnostic Services.

The new reimbursement restrictions do not apply to equipment, supplies and diagnostic

services. Thus, health FSAs can continue to reimburse the cost of bandages, crutches or blood sugar test kits obtained without a prescription. These items will continue to qualify as medical expenses if they otherwise meet the definition of medical care.

Impact on Debit Cards

OTC medicine and drug purchased on or after January 1, 2011 must be substantiated before reimbursement can be made. Substantiation is accomplished by submitting to the plan administrator the prescription (or a copy or other document that a prescription has been issued) for the OTC medicine or drug or other information from an independent third party that satisfies the cafeteria plan substantiation rules. For example, a customer receipt issued by a pharmacy that includes the name of the patient, the date and amount of the purchase, and the prescription number is considered proper substantiation for OTC medicines and drugs.

Because debit card systems will not be capable of substantiating whether OTC medicines or drugs are prescribed, health FSA and HRA debit cards may not be used

¹ The “Affordable Care Act” includes the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010.

² For medicine and drugs purchased after December 31, 2010, a distribution from a health savings account (“HSA”) or Archer Medical Savings Account (“Archer MSA”) will qualify as a tax-free qualified medical expense only if the medicine or drug requires a prescription, is an over-the-counter medicine or drug and the individual obtains a prescription or is insulin. Amounts distributed from an HSA or Archer MSA for nonqualified medical expenses are includible in gross income and generally subject to a 20% additional tax.

to purchase OTC medicines or drugs after December 31, 2010. However, the IRS has granted a transition period through January 15, 2011 during which time it will not challenge the use of health FSA and HRA debit cards to reimburse expenses for OTC medicines and drugs if such programs otherwise comply with current debit-card rules.

Effective Date

These new restrictions apply to medical expenses incurred after December 31, 2010, regardless of plan year (calendar year or fiscal year), coverage period in the case of an HRA or any health FSA grace period. Thus, expenses for non prescribed OTC medicines and drugs incurred during a health FSA grace period in 2011 (generally from January 1, 2011 through March 15,

2011) will not be eligible for reimbursement. Employers should notify participants of these changes before the end of 2010.

Transition Rule for Cafeteria Plan Amendments

Cafeteria plans may need to be amended to conform to the new OTC medicine and drug requirements. The amendment must be adopted no later than June 30, 2011 and may be effective retroactively for expenses incurred after December 31, 2010, or after January 15, 2011 for health FSA and HRA debit card purchases.

We continue to monitor the relevant federal agencies as the implementation of healthcare reform moves forward and will provide timely updates as notable developments occur.

Because debit card systems will not be capable of substantiating whether OTC medicines or drugs are prescribed, health FSA and HRA debit cards may not be used to purchase OTC medicines or drugs after December 31, 2010.

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