



Legal Alert: IRS Issues Guidance on Health FSA and HRA Debit Card Use for Over-the-Counter Drugs

1/4/2011

On December 23, 2010, the Internal Revenue Service issued Notice 2011-5, new guidance regarding the use of health FSA and HRA debit cards for purchases of over-the-counter medicines or drugs. Under previously issued IRS guidance (see Ford & Harrison Legal Alert dated 9/8/2010) the IRS indicated that health FSA and HRA debit cards could not be used to purchase over-the-counter medicines or drugs after January 15, 2011, except with respect to "90% pharmacies." Notice 2011-5 modifies this previously issued guidance. Under Notice 2011-5, the health FSA and HRA debit card purchases of over-the-counter medicines or drugs after January 15, 2011 will be considered fully substantiated at the time and point of sale if the conditions set forth below are met.

I. For non-health care merchants that have pharmacies and at mail order and web-based vendors that sell prescription drugs if:

- Prior to the purchase, the prescription for the over-the-counter medicine or drug is presented in any format to the pharmacist; the over-the-counter medicine or drug is dispensed by the pharmacist in accordance with applicable laws and regulations; and an Rx number is assigned;
- In accordance with IRS recordkeeping requirements, the pharmacy or other vendor retains a record of the Rx number, the name of the purchaser or person for whom the prescription applies, and the date and the amount of the purchase;
- All of these records are made available to the employer or its agent upon request;
- The debit card system does not accept a charge for an over-the-counter medicine or drug unless an Rx number has been assigned; and
- The IRS rules applicable to health FSA or HRA debit card use prior to the health care reform law are satisfied. (i.e., Prop. Reg. § 1.125-6; Rev. Rul. 2003-43; Notice 2006-69; Notice 2007-2; and Notice 2008-104).

II. For vendors (other than those described under I above) which have healthcare-related merchant codes, if:

- In accordance with IRS recordkeeping requirements, the vendor retains the name of the purchaser or name of the person for whom the prescription

applies and the date and amount of the purchase.

- All of these records are available to the employer or its agent upon request; and
- The IRS rules applicable to health FSA and HRA debit card use prior to the health care reform law are satisfied.

III. For pharmacies where 90 percent of the store's gross receipts during the prior taxable year consists of items that qualify as expenses for medical care under Section 213(d), health FSA and HRA debit cards may continue to be used for purchases of over-the-counter medicines or drugs as provided in IRS Notice 2010-59.

IRS Notice 2011-5 is effective for any health FSA or HRA debit card purchases of over-the-counter medicines or drugs made after January 15, 2011. Over-the-counter medicine or drug purchases with a health FSA or HRA debit card are not allowed after January 15, 2011 at any vendor if not made in accordance with the rules under Notice 2011-5. Employers who allow health FSA or HRA debit card use under their plan should begin now to communicate the changes to their employees, coordinate with their third party administrators for the FSA or HRA plans and evaluate any necessary amendments to their plan documents.

If you have any questions regarding this Alert, or would like additional details concerning health care reform, you can contact the author of this Alert, Daniel Sulton, dsulton@fordharrison.com, any member of Ford & Harrison's Employee Benefits practice group or the Ford & Harrison attorney with whom you usually work.

You may also visit the health care reform tab of the Ford & Harrison website for more helpful resources and tools on health care reform.