



September 2010

IRS Provides Guidance on OTC Drugs

The Patient Protection and Affordable Care Act (PPACA) changes the definition of eligible medical expenses for employer-provided accident and health plans (including Flexible Spending Accounts (FSAs) and Health Reimbursement Arrangements (HRAs)). The new definition applies to all employer-sponsored health care plans – both grandfathered and non-grandfathered plans – beginning on January 1, 2011. . PPACA also revised the definition of “qualified medical expense” for Archer Medical Savings Accounts (MSAs) and Health Savings Accounts (HSAs). To address these revised definitions, the IRS issued guidance (Notice 2010-59) on September 3, 2010. Following is a summary of that IRS guidance.

As of January 1, 2011, over the counter (OTC) medicines and drugs will generally not be eligible expenses for employer-sponsored health plans. Medicines and drugs that may still be reimbursed under employer-sponsored plans are:

- Medicine or drugs that require a prescription under Federal law;
- Medicine or drugs that do not require a prescription under Federal law (OTC drugs) if the individual obtains a prescription; and
- Insulin.

Similar rules also limit distributions from a HSAs and MSAs.

PPACA did not change the status of over the counter items that are not medicines or drugs. Equipment such as crutches, supplies such as bandages, and diagnostic devices such as blood sugar test kits continue to be eligible expenses.

Unlike many of the provisions of PPACA, this change does not apply based on the employer’s plan year. **The new rules apply to all medicines or drugs purchased after December 31, 2010.** Key items from the IRS Notice:

- OTC medicines or drugs purchased before January 1, 2011 can be reimbursed by an employer-sponsored plan even if the claim is submitted after January 1.
- OTC medicines or drugs purchased after December 31, 2010 cannot be reimbursed from an FSA even if the FSA has a grace period.
- FSA and HRA debit cards may continue to be used for medical expenses other than OTC medicines and drugs.
- After January 16, 2011, OTC medicines or drugs purchased using a debit card must be substantiated before reimbursement may be made. (The IRS stated that it will not challenge the use of FSA and HRA debit cards for expenses incurred through January 15, 2011.)

- OTC medicines or drugs may be substantiated in one of two ways:
 - Documentation by an independent third party that includes the name of the patient, the date and amount of the purchase and an Rx number. An example is a receipt from a pharmacy, which includes all of the required information.
 - Documentation by an independent third party with all required information except an Rx number plus a copy of the related prescription.

Cafeteria plans that currently cover OTC drugs and medicines must be amended. Cafeteria plans must comply with the new rules beginning on January 1, 2011, but under a special transition rule have until June 30, 2011 to make formal amendments.

The IRS also provided 10 FAQs along with Notice 2010-59. The full text of Notice 2010-59 and the FAQs can be found at:

Notice 2010-59 <http://www.irs.gov/pub/irs-drop/n-10-59.pdf>

FAQs <http://www.irs.gov/newsroom/article/0,,id=227308,00.html>

Please contact your Gallagher Benefit Services representative if you have any questions.