



NEW OVER-THE-COUNTER DRUG RULES FOR TAX-FAVORED HEALTH ACCOUNTS HEALTHCARE REFORM IN AMERICA – Part III

June 2010

*THIS EDITION OF OUR SERIES – **HEALTHCARE REFORM IN AMERICA**- WILL DISCUSS IMPORTANT CHANGES TO TAX-FAVORED HEALTH ACCOUNTS BEGINNING JANUARY 1, 2011. WE WILL DISCUSS WHEN OVER-THE-COUNTER (OTC) DRUG PURCHASES NO LONGER QUALIFY FOR REIMBURSEMENT AND SUMMARIZE WHAT VENDORS ARE SAYING ABOUT THE NEW RESTRICTIONS. WE HAVE PROVIDED **QUESTIONS AND ANSWERS** AT THE END OF THIS **INSIGHTS** TO HELP YOU ANSWER YOUR EMPLOYEES QUESTIONS ABOUT THESE LIMITATIONS.*

WHAT THE LAW REQUIRES

Effective January 1, 2011 drugs and medicine (except insulin) will require a prescription to qualify as an “eligible medical expense” that can be paid for using funds from a healthcare Flexible Spending Account (FSA), a Health Reimbursement Arrangement (HRA) or a Health Savings Account (HSA). Individuals will no longer be able to use an FSA, HRA or HSA to purchase over-the-counter drugs and medicine, unless accompanied by a prescription. A few points of interest:

- ◆ Reimbursement for unprescribed OTC drugs and medicine purchases is restricted beginning January 1, 2011 **regardless of the underlying plan year**.
- ◆ An OTC drug or medicine with a prescription will continue to be eligible for reimbursement.
- ◆ Other types of OTC purchases will continue to qualify for reimbursement from FSAs, HRAs, and HSAs.

WHAT THE VENDORS ARE SAYING

A number of vendors are weighing in on what the new law means and how employees can continue to use their accounts. In particular, effective January 1, 2011, Inventory Information Approval Systems, (IRS sanctioned technology to track qualified medical expenses) will no longer approve certain OTC drugs and medicines at the point of sale, and therefore, a debit card purchase will be denied. An individual who has an OTC medication prescription would pay for the medication and submit a

documented claim to be reimbursed.

Examples of OTC expenses that will no longer be approved without a prescription include: acid controllers, cough, cold and flu remedies, digestive aids, pain relief medications, antibiotics, stomach remedies, anti-itch and insect bite treatments, sleep aids and sedatives.

Examples of OTC products that should continue to be qualified expenses include: bandages, contact lens supplies, diagnostic tests and monitors, certain first aid supplies, wheelchairs, walkers and canes.

BACK TO THE FUTURE

In summary, the current OTC restrictions basically bring us back to early 2003 before OTC purchases were considered “qualified medical expenses”.

[SEE THE QUESTIONS AND ANSWERS AT THE END OF THIS INSIGHTS FOR MORE INFORMATION](#)

ADDITIONAL INFORMATION

For specific questions concerning information contained in this *Insights*, please contact your Chernoff Diamond consultant.

Information contained in this *Insights* is not intended to render tax or legal advice. Employers should consult with qualified legal and/or tax counsel for guidance in respect of matters of law, tax and related regulation.

Chernoff Diamond provides comprehensive consulting and administrative services with respect to all forms of employee benefits, risk management and qualified and non-qualified retirement plans.

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QUESTIONS AND ANSWERS – NEW OVER-THE-COUNTER DRUG RULES FOR TAX-FAVORED HEALTH ACCOUNTS

Q1 What types of tax-favored health accounts are impacted by this change?

A1 Over-the-counter drugs and medicines (OTC) will no longer be considered “qualified medical expenses” and will not be allowed to be reimbursed from Healthcare Flexible Spending Accounts (FSAs), Health Reimbursement Arrangements (HRAs) and Health Savings Accounts (HSAs).

Q2 When does the change take place?

A2 The restriction becomes effective **on January 1, 2011**. Therefore, any purchases you make for over-the-counter drugs after December 31, 2010 will no longer qualify as eligible expenses and cannot be reimbursed from these accounts.

Note: All plans, regardless of the plan year, will be impacted by these changes on January 1, 2011. If your plan is not a calendar-year plan year (i.e. April 1 – March 31), and employees have already made irrevocable pre-tax elections to a Flexible Spending Account, they need to be aware they cannot be reimbursed for these purchases beginning January 1, 2011. Employees should carefully consider their 2010 OTC needs in order not to forfeit any unused balance at the end of the FSA plan year. Those who will be making elections during the remaining months of 2010 should also be cautioned as to these limitations.

Q3 What if my doctor writes a prescription for an over-the-counter medication?

A3 As long as you have a prescription, you may be reimbursed for these expenses.

Q4 Will I be able to use my FSA, HRA, or HSA debit card if I have a prescription for an over-the-counter medication?

A4 No. You will need to pay for the medication and file a claim with proper documentation, which presumably would include the prescription. At this time, the IRS has not commented on what documentation will be required in order to be reimbursed for the purchase.

Q5 I understand that our FSA has a grace period that allows us to make purchases up to March 15 of the following year. Will over-the-counter purchases of drugs or medicines made during the grace period be allowed?

A5 No. All over-the-counter drug or medicine purchases (without a prescription) must be made on or before December 31, 2010 in order to qualify for reimbursement.

Q6 I understand that our plan allows us to submit claims for reimbursement up to 30 days after the purchase.

If I purchase an over-the-counter drug in December, 2010 but do not submit the claim until January, 2011, will I still be allowed to be reimbursed for this purchase?

A6 Yes. As long as the expense was incurred before January 1, 2011 your claim will be reimbursed.

Q7 What types of over-the-counter drugs and medicines will no longer be allowed without a prescription?

A7 The following are some expense categories that will not be approved without a prescription.

Acid controllers	Digestive and stomach relief
Allergy and sinus	Insect bite and anti-itch
Antibiotic products	Motion sickness
Baby rash and ointments	Pain relief
Cough, cold and flu	Sleep aids and sedatives

Q8 Are there over-the-counter products that will be allowed to be reimbursed from the account without a prescription?

A8 Yes, your purchases for most over-the-counter products that are not considered drugs or medicines will still qualify for reimbursement.

Q9 Which over-the-counter products will continue to qualify for reimbursement?

A9 Some examples of over-the-counter products that will continue to qualify for account reimbursement include:

Band Aids	First aid supplies
Birth Control	Insulin and diabetic products
Braces and supports	Reading glasses
Contact lens supplies	Walkers and canes
Diagnostic tests	Wheelchairs

Q10 Will my deductible continue to qualify for reimbursement through the account?

A10 Yes. This provision was not affected by the law.

Q11 What happens if I use my Health Savings Account for an over-the-counter drug without a prescription after January 1, 2011?

A11 Beginning January 1, 2011, the distribution will not be a qualified medical expense and therefore, will be considered taxable income as well as be subject to an additional tax penalty of 20%.

Q12 Are there any other changes that may impact what will qualify for reimbursement from the account?

A12 The answers to all these questions are based on our current understanding of the law. However, we will let you know as soon as possible if the IRS or other regulatory agencies issue any guidance or make any changes to what is considered a “qualified medical expense” that is eligible for reimbursement under a FSA, HRA or HSA.