



Legislative Update

September 13, 2010

New Guidance on Over-the-Counter Medicines and Drugs

Health care reform established new restrictions on the reimbursement of over-the-counter (OTC) medicines and drugs purchased after December 31, 2010 under employer-provided accident and health plans (including health flexible spending arrangements (health FSAs)). The IRS has now released [guidance](#) and [FAQs](#) on the new restrictions, revising the definition of medical expenses for health FSAs, health reimbursement arrangements (HRAs), Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (Archer MSAs).

The health reform law established a new uniform standard for medical expenses effective January 1, 2011. Specifically, only prescribed medicines or drugs (including OTC medicines and drugs that are prescribed) and insulin (even if purchased without a prescription) will be considered qualifying medical expenses and subject to preferred tax treatment. The guidance states that for purposes of the new rule only, 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 has been issued by an individual who is legally authorized to issue a prescription in that state.

Effective Date:

The changes are effective for purchases of OTC medicines and drugs without a prescription after December 31, 2010. The changes do not affect purchases of OTC medicines and drugs in 2010, even if they are reimbursed after December 31, 2010. Thus, claims for OTC medicines or drugs purchased without a prescription in 2010 can still be reimbursed in 2011, if allowed by the employer's plan. This new law change doesn't affect HSA or Archer MSA distributions for medicines or drugs made before January 1, 2011, nor does it affect distributions made after December 31, 2010, for medicines or drugs purchased on or before that date.

Plan Year:

The OTC restriction begins January 1, 2011, regardless of an employer's plan year. A non-calendar year plan may need to impose two different coverage rules in one plan year (before and after January 1, 2011). Plans that run on a calendar year will face fewer implementation problems, since the coverage change will occur at the start of a new plan year.

Grace Period:

Some health FSAs allow participants to incur expenses during a 2-1/2 month grace period after the plan year ends. Under these plans, all non-prescribed OTC drug expenses must be incurred in 2010 to qualify for tax-free reimbursement (non-

prescribed OTC drug expenses incurred during a grace period in 2011 won't be reimbursed on a tax-free basis).

Qualified Health Care Expenses:

The guidance also clarifies that the new rule does not apply to items for medical care that are not medicines or drugs. The rules for reimbursing these items remain unchanged (e.g., they must be for medical care and not merely beneficial to an individual's general health). Thus, other qualified health care items such as medical devices, eye glasses, crutches, bandages, contact lenses, diagnostic kits, copays, and deductibles will still qualify for reimbursement if purchased after December 31, 2010.

Debit Cards:

Plans that issue debit or credit cards that are used to pay for OTC medicines or drugs must ensure that the card is reprogrammed no later than January 15, 2011, so that the card can no longer be used to purchase OTC medicines or drugs.

Communication:

Employers that currently permit tax-free reimbursements for all OTC medications and drugs will need to communicate this change to employees. Summary plan descriptions, claim and enrollment forms, and explanatory materials given to participants in HSAs and MSAs will likely need revising to reflect the new rule. Administrators may want to consider informing participants of the change now in order to give them an opportunity to use their funds to purchase non-prescribed OTC drugs before the new restriction goes into effect. Employers that currently reimburse expenses for non-prescribed OTC medications and drugs will need to amend their plan documents for the new restriction and specify whether the plan will reimburse prescribed OTC medications.

As new information is issued on health reform, Conner Strong will issue alerts and updates. Should you have any questions, please **contact your Conner Strong representative toll-free at 1-877-861-3220**.

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