

LEGAL UPDATES

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# IRS Guidance on Reimbursement of Over-The-Counter Drugs from Employer Plans

On September 3, 2010, the IRS published guidance pertaining to the reimbursement of over-the-counter medicine and drugs (OTC drugs) from employer-sponsored health plans. Current law permits employer-sponsored health plans, including flexible spending arrangements, health reimbursement arrangements, health savings accounts and Archer medical savings accounts, to provide tax-free reimbursement for all OTC drugs. As part of this year's Healthcare Reform legislation, employer plans will no longer be permitted to reimburse expenses for OTC drugs with two exceptions: (1) OTC drugs for which a participant has a valid prescription; and (2) insulin.

The prohibition is effective for OTC drugs purchased without a prescription after December 31, 2010. This means that amounts contributed to employer plans before the effective date may not be used to reimburse OTC drug expenses incurred on or after January 1, 2011. In addition, flexible spending accounts with grace periods that allow reimbursement for expenses incurred during the first 2 1/2 months of the following plan year using funds contributed for 2010 may not reimburse OTC drug expenses incurred on or after January 1, 2011 unless the purchases qualify for one of the exceptions. On the other hand, OTC drug expenses that were incurred before January 1, 2011 may be reimbursed after December 31, 2010 in accordance with ordinary employer plan rules.

The guidance clarifies that the prohibition on the reimbursement of OTC drugs does not apply to over-the-counter medical equipment such as crutches, bandages and blood sugar test kits, if such items are for medical care as defined by the Internal Revenue Code. The guidance also provides that a valid

prescription under applicable state law is necessary to have a valid reimbursement of prescribed OTC drugs.

Health flexible spending and health reimbursement debit cards may no longer be used to purchase OTC drugs. Nevertheless, the IRS will not challenge the use of debit cards for expenses incurred through January 15, 2011. Also, to conform to the new law, cafeteria plan amendments may be made as late as June 30, 2011, effective retroactively for expenses incurred after December 31, 2010 or after January 15, 2011 for FSA and HRA debit card purchases.

### **What This Means To You**

If you sponsor a health plan that currently reimburses OTC drugs, you should review the plan and may need to take one or all of the following steps:

Evaluate whether you need to amend your plan to comply with this guidance, and adopt any required amendment by June 30, 2011.

Ensure that the debit cards may not be used to reimburse OTC drugs on or after January 15, 2011.

Communicate to participants that except for insulin, purchases of OTC drugs made on or after January 1, 2011 are not eligible for reimbursement without a prescription.

Review open enrollment materials, summary plan descriptions and other participant communications to ensure the new rules are communicated to participants.

Note that, even if you have a non-calendar year health plan that reimburses OTC drugs, the new rule will still go into effect on January 1, 2011 and will impact your plan.

### **Contact Info**

Please contact your Husch Blackwell attorney or a member of the Employee Benefits and Executive Compensation practice group if you have questions or if we can assist in any way.

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