

IRS Issues Guidance for Tax Free Reimbursement of Over-the-Counter Medicine and Drug Expenses

The Patient Protection and Affordable Care Act (the "PPACA") amended the Internal Revenue Code to restrict tax free reimbursements for medicine or drugs under an employer provided health care plan, including a health care flexible spending account ("FSA") or health reimbursement account ("HRA"), or under a health savings account ("HSA") or Archer MSA. Under the new rules reimbursement for medicine or drugs is tax free only if the medicine or drug (i) requires a prescription, (ii) is available over-the-counter (i.e., without a prescription) but the individual obtains a prescription anyway, or (iii) is insulin. The restrictions apply to reimbursements for any expenses incurred after December 31, 2010. Reimbursements for over-the-counter drugs purchased without a prescription after the end of this year will be treated as taxable income and, if made from a HSA or Archer MSA, will also generally be subject to a twenty percent (20%) additional tax.

The IRS has issued guidance for the application of these new restrictions. Here are some of the highlights.

- Tax free reimbursements may continue to be made any time after December 31, 2010 for over-the-counter medicine or drugs purchased without a prescription before January 1, 2011.
- The new restrictions do not apply to over-the-counter items other than medicine or drugs that otherwise qualify as medical supplies, such as crutches, bandages and diagnostic devices, such as blood sugar test kits.
- Use of debit cards for health care FSA or HRA reimbursements will be severely limited.
 - Subject to the exceptions noted below, health care FSA and HRA debit cards may not be used to purchase over-the-counter medicine or drugs after December 31, 2010, whether or not the individual has obtained a prescription for them. Current debit card systems are incapable of recognizing and substantiating whether over-the-counter medicine or drugs were prescribed.
 - The IRS will not challenge use of health care FSA and HRA debit cards for over-the-counter medicine or drug expenses incurred through January 15, 2011 if the use of the debit cards otherwise complies with current IRS guidance.
 - Generally, over-the-counter medicine or drug purchases with a prescription will have to be substantiated before tax free reimbursement can be made. This may require, for example, (i) a receipt with the name of the purchaser, the date and amount of the purchase, and a prescription number, or (ii) a receipt without a prescription number accompanied by a copy of the related prescription.
 - Health care FSA and HRA debit cards may continue to be used to purchase prescribed over-the-counter medicine or drugs at a pharmacy where at least ninety percent (90%) of gross receipts during the prior taxable year consisted of items that qualify as deductible medical expenses, so long as substantiation (e.g., a copy of the prescription and other information from an independent third party that satisfies prior IRS guidance) is properly submitted.
- Required amendments to cafeteria plans may be adopted by June 30, 2011 and made retroactive for expenses incurred after December 31, 2010.

If you have questions or would like additional information about the new restrictions on tax free reimbursements for

over-the-counter medicine or drugs, please feel free to contact Brian Dougherty at (215) 587-5919 or bdougherty@postschell.com.

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