

**Tax-Favored Reimbursement of Over-The-Counter Drugs
Limited Effective January 1, 2011**

December 13, 2010

The Patient Protection and Affordable Care Act has revised the definition of medical expenses which may be reimbursed on a tax-favored basis under an employer-provided health plan, including a health flexible spending account (“FSA”) and health reimbursement arrangement (“HRA”), as well as a Health Savings Account (“HSA”) and Archer Medical Savings Account (“MSA”). Effective January 1, 2011, the cost of an over-the-counter medicine or drug cannot be reimbursed from such tax-favored accounts unless a prescription is obtained (or the drug is insulin). Although the new law applies to drugs purchased after December 31, 2010, an employer may amend its cafeteria plan to conform to the new law no later than June 30, 2011.

REIMBURSEMENT LIMITED TO PRESCRIBED DRUGS OR INSULIN

An employee is not subject to income tax on amounts paid as reimbursement for medical care under an employer-sponsored health plan. Effective January 1, 2011, expenses incurred for a medicine or drug can only be treated as a reimbursement for medical care if the medicine or drug is prescribed (regardless of whether the drug is available without a prescription) or is insulin. Consequently, expenses for medicines or drugs may be paid or reimbursed by an employer-provided plan, including a health FSA or HRA, only if (1) the medicine or drug requires a prescription, (2) is available without a prescription (*i.e.*, an over-the-counter medicine or drug) and the individual obtains a prescription, or (3) is insulin. Expenses incurred for over-the-counter medicines or drugs purchased before January 1, 2011, may be reimbursed tax-free at any time pursuant to the terms of the employer’s plan. Similar rules also apply to an HSA or Archer MSA. This limitation does not apply to items that are not medicines or drugs, such as crutches, supplies such as bandages, and diagnostic devices such as blood sugar test kits.

USE OF HEALTH FSA AND HRA DEBIT CARDS

Current debit card systems used with FSA and HRA plans are generally incapable of recognizing and substantiating whether the over-the-counter medicines or drugs have been prescribed. After January 15, 2011, such debit cards may not be used to purchase over-the-counter medicines or drugs. Purchases of over-the-counter medicines or drugs after January 15, 2011, from any merchant or provider must be substantiated before reimbursement may be made. Substantiation is accomplished by submitting a copy of the prescription, along with the receipt and other required documentation, to the plan administrator.

REQUIRED PLAN AMENDMENT

A cafeteria plan containing an FSA which reimburses over-the-counter medicines or drugs will need to be amended to restrict such reimbursement to prescribed drugs or insulin. Although cafeteria plan amendments may generally not be made retroactively, the IRS has permitted an amendment to conform a cafeteria plan to the new reimbursement rules retroactively to January 1, 2011, so long as the amendment is adopted no later than June 30, 2011. See IRS Notice 2010-59.

If you have questions regarding these recent developments, please contact [James E. Daniel](#), the principal author of this alert. You may also contact the Womble Carlyle attorney with whom you usually work, or one of our [Employee Benefits attorneys](#).

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