

Healthcare Reform FAQ: Over-the-Counter Medications

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General Information

On September 3, 2010, the Internal Revenue Service (IRS) issued guidance reflecting statutory changes under the Affordable Care Act regarding the use of certain tax-favored arrangements, such as flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs) and Archer Medical Savings Accounts (MSAs), to pay for over-the-counter (OTC) medications.

The following questions and answers were drafted to help you understand how this guidance may affect you.

Information for Plan Participants

Q1: How are the rules changing for health FSAs and HRAs?

A1: Effective January 1, 2011, distributions from health FSAs and HRAs will only be allowed to reimburse the cost of most OTC medications if they are purchased with a prescription. This new rule does not apply to reimbursements for the cost of insulin or OTC medical devices/supplies, which will continue to be permitted without a prescription.

Q2: How are the rules changing for HSAs and Archer MSAs?

A2: Effective January 1, 2011, only prescribed medicines or drugs, including OTC medicines and drugs that are prescribed, will be considered qualifying medical expenses and subject to preferred tax treatment. This new rule does not apply to reimbursements for the cost of insulin, which will continue to be considered qualifying medical expenses and subject to preferred tax treatment, even if purchased without a prescription.

Q3: When will the changes become effective?

A3: The changes are effective for OTC medications purchased on or after January 1, 2011. The changes do not affect purchases of OTC medicines and drugs in 2010, even if they are reimbursed after December 31, 2010.

Q4: How do I prove that I have purchased an OTC medication with a prescription?

A4: If your employer's health FSA or HRA reimburses these expenses, you will need to provide either:

- the prescription (or a copy of the prescription or another item showing that a prescription for the item has been issued) and a receipt that includes the date and amount, or
- a receipt that shows the prescription number, date of the sale, amount of the charge, and the name of the person for whom the prescription applies.

Q5: What information needs to be included on the prescription for OTC medications?

A5: Neither the Affordable Care Act nor the IRS guidance goes into this level of detail. IRS Notice 2010-59 states, "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 that is issued by an individual who is legally authorized to issue a prescription in that state."

- Q6: How does this change affect OTC medical devices and supplies?**
A6: The new rule does not apply to items for medical care that are not medicines or drugs. Equipment such as crutches, supplies such as bandages, and diagnostic devices such as blood sugar test kits will still qualify for reimbursement by a health FSA or HRA purchased after December 31, 2010. A distribution from an HSA or Archer MSA for the cost of such items will still be tax-free, regardless of whether the items are purchased using a prescription..
- Q7: Will I need a prescription to use my health FSA, HRA, HSA or Archer MSA funds for insulin purchases after December 31, 2010?**
A7: No. You can continue to use your health FSA, HRA, HSA or Archer MSA funds to purchase insulin without a prescription after December 31, 2010.
- Q8: I use health FSA funds for my copayments and deductibles. Will I still be able to reimburse those expenses with health FSA funds after December 31, 2010?**
A8: Yes. Copayments and deductibles continue to be reimbursable from a health FSA after December 31, 2010. Similarly, funds from an HRA can continue to be used for these expenses and a distribution from an HSA or Archer MSA for these purposes will be tax-free.
- Q9: My employer gives me two extra months beyond the end of the year to submit claims for health FSA expenses incurred during the year. What happens if I purchase OTC medicines or drugs without a prescription in 2010 but do not submit the claim for those expenses until January 2011? Will they qualify for reimbursement?**
A9: Yes. The new restriction on plan reimbursements for the cost of OTC medicines or drugs without a prescription applies only to purchases that are made on or after January 1, 2011.
- Q10: My employer's health FSA includes a grace period, so that I can still use the amount left in my health FSA at the end of the year to reimburse expenses I incur during the first two and a half months of the following year. If I buy OTC medications without a prescription during the grace period of 2011, can I still use the amount left in my health FSA at the end of 2010 to reimburse those expenses?**
A10: No. The change applies to purchases made on or after January 1, 2011. Even if your employer's plan includes the grace period provision, the cost of OTC medicines and drugs purchased without a prescription during the first two and a half months of 2011 will not be eligible to be reimbursed by a health FSA.
- Q11: If my plan issues a debit or credit card that I use to pay for OTC medicines or drugs, will I still be able to use the card to purchase OTC medicines or drugs?**
A11: After January 15, 2011, the Benny™ Card may continue to be used to purchase OTC medicines or drugs at drug stores, pharmacies, mail order and Web-based vendors if: (1) you have a prescription, (2) it is dispensed by the pharmacist, and (3) an Rx number is assigned. These Benny™ Card transactions will be considered fully substantiated at the time and point-of-sale. Other guidelines apply. Please see IRS notices [2010-59](#) and [2011-05](#) for full details.
- Q12: If I use HSA or Archer MSA funds to reimburse the cost of OTC medicines or drugs purchased after December 31, 2010 without a prescription, what taxes will I incur?**
A12: If you have an HSA or Archer MSA, the amount of the distribution for expenses that are not qualifying medical expenses will be includable in your gross income and subject to an additional tax of 20 percent.

Q13: How does the new rule apply if my plan year starts on a date other than January 1?

A13: The change applies to the tax year (calendar year) beginning 2011, not your FSA or HRA plan year. For example, if your company's plan year begins on June 1, the change is still effective January 1, 2011.

Q14: Who can I contact for more information?

A14: You are welcome to contact our Customer Service Department at (800) 422 7038 or psacustomerservice@pacificsource.com.

For questions related to PacificSource HSA plans, feel free to contact PacificSource Customer Service at (888) 977-9299 or cs@pacificsource.com.

Information for Employers

Q1: Will I need to amend my organization's cafeteria plan to reflect the new rules for reimbursing the cost of OTC medicines and drugs?

A1: Yes. Cafeteria plans may need to be amended to conform to the new OTC drug requirements.

Q2: What is the deadline for cafeteria plans to be amended to reflect this change?

A2: Cafeteria plan sponsors have until June 30, 2011 to amend their plans to conform to the new OTC drug requirements, so long as the amendment is effective retroactively for expenses incurred after December 31, 2010 (or after January 15, 2011 for health FSA and HRA debit card purchases).

Q3: Who can I contact for more information?

A3: You are welcome to contact our Customer Service Department at (800) 422 7038 or psacustomerservice@pacificsource.com.

For questions related to PacificSource HSA plans, contact your PacificSource Client Service Representative.