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Health Care Reform — IRS Addresses Treatment of Over-the-Counter Medicines under Medical Reimbursement Arrangements

The Internal Revenue Service recently issued guidance addressing the new rules for reimbursing over-the-counter (“OTC”) medicines contained in the Patient Protection and Affordable Care Act of 2010, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the “Health Care Reform Act”). This alert summarizes the more important aspects of that guidance for employer-sponsored medical reimbursement arrangements.

New Rule — OTC Medicines No Longer Reimbursable

Before enactment of the Health Care Reform Act, expenses for OTC medicines were reimbursable without a prescription under healthcare flexible spending accounts (“FSAs”), health reimbursement arrangements (“HRAs”), health savings accounts, and other tax-favored medical expense reimbursement arrangements. Under the new law, however, expenses for OTC medicines purchased *after* December 31, 2010 will not be eligible for reimbursement under those arrangements, *unless* the medicine is either —

- obtained with a prescription, or
- insulin.

Note, though, that this rule does *not* apply to non-drug items, such as bandages and diagnostic devices.

The new rule will go into effect on January 1, 2011 for all medical reimbursement arrangements regardless of the arrangement’s plan year or, for healthcare FSAs, whether the arrangement provides a 2-1/2 month grace period for eligible 2010 expenses. OTC medicines that are purchased before the end of 2010, but are not submitted for reimbursement until 2011, may still be reimbursed.

Use of Debit Cards

The IRS guidance also provides that FSA and HRA debit cards generally *cannot* be used to pay for OTC medicines purchased after January 15, 2011. For purchases made after that date, OTC medicines may not be reimbursed until appropriate substantiation is provided. However, the guidance does provide a limited exception for pharmacies that meet a “90% gross receipts” test (i.e., 90% of the gross receipts for the pharmacy’s prior taxable year consisted of eligible medical expense items). Participants can continue to use debit cards to pay for OTC medicines

at these pharmacies, subject to the participant providing sufficient proof to the plan in accordance with existing IRS debit card guidelines.

Required Cafeteria Plan Amendments

The guidance provides that, regardless what “plan year” a cafeteria plan uses, any plan that provides a healthcare FSA program must be amended (as needed) to reflect the new OTC reimbursement rules. Although cafeteria plan amendments generally may only be applied prospectively, such an amendment

may be applied retroactively so long as it is adopted by June 30, 2011.

As a reminder, cafeteria plan sponsors will also want to consider whether an amendment should be made so that dependent coverage for adult children under age 26 can be offered under the plan on a tax-free basis in 2010. In this connection, while the adult child coverage mandate under the Health Care Reform Act is not effective until the first day of the first plan year that begins on or after September 23, 2010 (i.e., January 1, 2011 for calendar year plans), an employer *may* offer such coverage on

a pre-tax basis beginning March 30, 2010 (the Health Care Reform Act’s enactment date), provided that any cafeteria plan amendments needed to document this are adopted by 2010 year end. Please see the May 2010 client alert entitled “[IRS Clarifies Tax Treatment of Coverage for Adult Children under the Health Care Reform Act](#)” for additional information.

We welcome the opportunity to assist you with these and other changes required under the Health Care Reform Act. Please let us know if you have any questions or if we can be of further assistance.

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