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IRS Releases Additional Guidance on OTC Restrictions

In Notice 2011-5, the IRS clarifies the circumstances under which debit cards can be used for the purchase of over-the-counter medicines and drugs after January 15, 2011.

Background

Before enactment of the Patient Protection and Affordable Care Act (PPACA), employer health plans were allowed to cover over-the-counter (OTC) medicines and drugs on a tax-favored basis. PPACA added new provisions to the Internal Revenue Code (Code) that revise the definition of medical care and limit the ability of plans to reimburse OTC items. Specifically, the cost of most OTC medicines and drugs are not eligible for reimbursement under medical plans, including health flexible spending accounts (FSA) and health reimbursement accounts (HRA). (See our April 21, 2010 [For Your Information](#).) PPACA provides reimbursements are only available for insulin, OTC medicines and drugs prescribed by a physician, and OTC items that are not medicines or drugs but otherwise meet the definition of medical care (e.g., crutches, bandages, or blood sugar testing kits).

Many sponsors of HRAs and FSAs provide participants with debit cards that may be used to pay for covered health services. [Notice 2010-59](#) prohibited the use of debit card reimbursement for any OTC medicines and drugs after January 15, 2011, allowing an exception only for purchases from 90 percent pharmacies. A “90 percent pharmacy” is a store for which 90 percent of gross receipts during the prior taxable year consist of items that qualify as medical care expenses under Code Section 213(d). (See our September 9, 2010 [For Your Information](#).)

Notice 2011-5

[Notice 2011-5](#) modifies Notice 2010-59 to provide two additional circumstances in which consumers can use health FSA and HRA debit cards to purchase OTC medicines and drugs after January 15, 2011. These new exceptions are in addition to the exception for debit card purchases from 90 percent pharmacies.

BUCK COMMENT. *Plan sponsors, vendors, and participants have been hoping for a way to continue to use debit cards more broadly for OTC purchases. This new guidance is welcome news.*

The circumstances are as follows:

Purchases from Drug Stores and Pharmacies, Non-Health Care Merchants, and Mail Order/Web-Based Vendors. Participants and beneficiaries may continue to use health FSA and HRA debit cards to purchase OTC medicines and drugs from drug stores and pharmacies, non-health care merchants that have pharmacies, and mail order and web-based vendors that sell prescription drugs if all of the following requirements are met:

- **Point-of-Sale Requirements.** Prior to the purchase, the participant or beneficiary presents the prescription to the pharmacist, the pharmacist dispenses the OTC medicine or drug in accordance with applicable laws and regulations, and the pharmacist assigns the prescription an Rx number.
- **Record Retention.** The pharmacy or other vendor retains a record of the Rx number, the name of the purchaser, and the date and amount of the purchase in a manner that satisfies applicable IRS recordkeeping requirements.
- **Employer Access to Records.** The merchant's records are accessible to the employer or its agent upon request.
- **No Rx Number, No Charge.** The debit card system is designed so that it cannot accept a charge for an OTC medicine or drug unless a prescription number has been assigned.
- **Additional Rules Satisfied.** The transaction meets other requirements as set out in previous Treasury regulations and guidance that relate to cafeteria plans and safe harbor rules for debit and credit card purchases of eligible medical expenses with FSA or HRA funds.

Purchases from Health Care Merchants. Notice 2011-5 also provides that a debit card can be used to purchase OTC medicines and drugs at health-care merchants (e.g., physicians or vision care providers) with a health care merchant code if the merchant retains a record with the name of the purchaser, the date, and the amount of the purchase in a manner that satisfies the IRS recordkeeping requirements; the records are available to the employer or its agent upon request; and the requirements in previous Treasury regulations and guidance that relate to cafeteria plans and safe harbor rules for debit and credit card purchases of eligible medical expenses with FSA or HRA funds are met.

Purchases from 90 Percent Pharmacies. Notice 2011-5 also allows participants and beneficiaries to continue to use FSA or HRA debit cards to purchase OTC medicines and drugs from 90 percent pharmacies as provided in Notice 2010-59.

Conclusion

Notice 2011-5 provides welcome guidance for plan sponsors and vendors who have been grappling with the mechanics of the reimbursement of OTC items with a prescription.

Buck's consultants are available to assist you in understanding the impact of this guidance on your current plan and determining the extent to which this notice may inform future plan decisions.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.