



UPDATE!

Cafeteria Plan Restrictions for Over-the-Counter Medicines

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Clients and Friends:

September 10, 2010

The Affordable Care Act (i.e., Healthcare Reform) contained a section stating that beginning January 1, 2011, expenses incurred for medicines or drugs may be paid or reimbursed by an employer-provided plan, including a health FSA or HRA, only if the medicine or drug: (1) requires a prescription, (2) is an over-the-counter medicine or drug and the individual obtains a prescription, or (3) is insulin.

Purchases of over-the-counter (OTC) medicines and drugs will no longer be tax-free unless you have an appropriate prescription from a licensed health care professional. This is a big change for cafeteria plans and other tax-favored arrangements like Health Savings Accounts and Archer Medical Savings Accounts.

WE NOW HAVE MORE INFORMATION

On September 3, 2010, the Internal Revenue Service issued a new Revenue Ruling (Rev. Rul. 2010-23) and Guidance Notice on the "definition of medical expenses as it relates to over-the-counter drugs." For those of you who would like to read the six-page Notice, see <http://www.irs.gov/pub/irs-drop/n-10-59.pdf>.

The IRS tells us that for this purpose, a "prescription" is 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." (In Washington State this is determined by RCW 69.41)

Note that the new restrictions do not apply to items such as crutches, supplies such as bandages, and diagnostic devices such as blood sugar test kits. Such items may continue to qualify as medical care if they otherwise meet the IRS definition of medical care.

EFFECTIVE DATES AND PLAN DOCUMENT CHANGES

For all plans the effective date of this change is January 1, 2011, regardless of whether the plan year is a fiscal or calendar year plan. Thus, if your plan is not a calendar year plan, you may want to advise current participants of this change well in advance of the end of the year. Take care, though—although employees may consider stocking up on OTC items prior to January 1, 2011, anti-stockpiling rules only allow reimbursement of reasonable quantities of OTC medications.

In addition, cafeteria plan documents may need to be amended, but the IRS needs to provide further guidance on the definition of "drugs and medicines." The IRS is also allowing us an unusual opportunity to retroactively amend our plan documents, as long as the amendments are done by June 30, 2011.

USE OF DEBIT CARDS—A TWIST IN TIMING FOR SOME

Current debit card systems (often using the "Benny" card) are not capable of handling this change—they are incapable of recognizing and substantiating that the OTC medicines or drugs were prescribed. Thus, the IRS says that we will no longer be able to use debit cards to purchase over-the-counter medicines or drugs. Debit cards may continue to be used for medical expenses other than over-the-counter medicines or drugs.

Most debit card vendors will begin restricting debit card use as of January 1, 2011. However, the IRS says that it will not challenge the use of health FSA and HRA debit cards for expenses incurred through January 15, 2011 if the use of the debit cards is otherwise in compliance with law. This means that for some plans, the practical restriction will begin January 16, 2011.

If you have any questions or concerns regarding implementation of this cafeteria plan change, or how this will affect your group or your employees, please feel free to contact your Account Manager or call the Benefits Helpline at 206-957-7066 (toll-free 800-946-7066). You can also send an email to Questions@SIGinsures.com.

This HCR update and additional one-page HCR updates can be found on our Sprague Israel Giles, Inc. website. You can find us at <http://www.SIGinsures.com/employeebenefits.html>.

Questions? Call your Account Manager directly or the Benefits Helpline at 206.957.7066 www.SIGinsures.com