



TUESDAY, SEPTEMBER 7, 2010

## HEALTH CARE REFORM UPDATE

### IRS ISSUES GUIDANCE ON 2011 CHANGES TO FLEXIBLE SPENDING ARRANGEMENTS

On Friday, September 3, the Internal Revenue Services (IRS) issued guidance on changes regarding the use of Health Care flexible spending arrangements (FSAs), to pay for over-the-counter (OTC) medicines and drugs. According to the Patient Protection and Affordable Care Act (PPACA), there is a new uniform standard effective January 1, 2011, that applies to Health Care FSAs and health reimbursement arrangements (HRAs). Beginning on this date, OTC medicines or drugs cannot be reimbursed from a Health Care FSA or HRA unless a prescription is obtained. This applies only to purchases made on or after January 1, 2011, so claims for OTC medicines or drugs purchased in 2010 can still be submitted for reimbursement in 2011 if the employer's plan allows it. This change does not affect insulin, even when purchased without a prescription, nor does it affect other health care expenses such as medical devices, eye glasses, contact lenses, co-pays and deductibles. For more on these new guidelines, please review the Frequently Asked Questions (FAQs) we've pulled from the IRS website below. (To view the FAQs in their entirety, please visit: <http://www.irs.gov/newsroom/article/0,,id=227308,00.html>)

As your partner, we remain committed to working closely with you to help you understand and comply with the guidelines pertaining to the health care reform legislation. Clients receiving our FSA services can expect to hear from their Trion dedicated FSA Client Service Representative with additional details on how these guidelines affect their individual plans. We also encourage you and your employees to take these changes into account as you make health benefit decisions for 2011. Finally, we hope you find this information helpful and invite you to review past issues of our *Health Care Reform Update* at <http://www.trion.com/healthreform>. Please continue to share your questions and comments by emailing us at [health.reform@trion.com](mailto:health.reform@trion.com) or calling 610.945.1198. Thank you.

#### **IRS FAQs**

##### **Q. How are the rules changing for reimbursing the cost of OTC medicines and drugs from Health Care FSAs and HRAs?**

A. Effective January 1, 2011, both funds will only reimburse the cost of OTC medicines or drugs only if they are purchased with a prescription. This new rule does not apply to reimbursements for the cost of insulin, which will continue to be permitted, even if purchased without a prescription.

##### **Q. How are the rules changing for distributions from health savings accounts (HSAs) and Archer Medical Savings Accounts (Archer MSAs) that are used to reimburse the cost of OTC medicines and drugs?**

A. Only prescribed medicines or drugs (including OTC medicines and drugs that are prescribed) and insulin (even if purchased without a prescription), will be considered qualifying medical expenses and subject to preferred tax treatment.

##### **Q. When will the changes become effective?**

A. The changes are effective after December 31, 2010. They do NOT affect purchases of OTC medicines and drugs in 2010, even if they are reimbursed after December 31, 2010.

**Q. How do I prove that I have purchased an OTC medicine or drug with a prescription so that I can get reimbursed from my employer's Health Care FSA or an HRA?**

A. You would provide the prescription (or a copy of the prescription or another item showing that a prescription for the item has been issued) and the customer receipt (or similar third-party documentation showing the date of the sale and the amount of the charge). For example, documentation could consist of a customer receipt issued by a pharmacy that reflects the date of sale and the amount of the charge, along with a copy of the prescription. Or, it could consist of a customer receipt that identifies the name of the person buying the prescription (or the name on the prescription), the date, cost and an Rx number.

**Q. How does this change affect over-the-counter medical devices and supplies?**

A. It doesn't. Therefore, 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 Care FSA or HRA if purchased after December 31, 2010, and 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.

**Q. I use Health Care FSA funds for my co-pays and deductibles. Will I still be able to reimburse those expenses after December 31, 2010?**

A. Yes. Co-pays and deductibles continue to be reimbursable from a Health Care 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.

**Q. My company 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?**

A. 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 after 2010.

**Q. My company's Health Care FSA includes a provision for a grace period. If I buy OTC medicines or drugs without a prescription during the 2 1/2 month grace period of 2011, can I still use the amount left in my Health Care FSA at the end of 2010 to reimburse those expenses?**

A. No. The change applies to purchases made on or after January 1, 2011. So even if your employer's plan includes a grace period provision, the cost of OTC medicines and drugs purchased without a prescription during that grace-period will not be eligible for reimbursement.

**Q. 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?**

A. 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%.

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