

## Employee Benefits Alert

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### Over-the-Counter Medications May Now Be Reimbursed

The IRS and Treasury Department recently published Revenue Ruling 2003-102 which allows employees to be reimbursed under their health reimbursement plans for the purchase of over-the-counter (OTC) medicines or drugs. Employers should note that this Ruling impacts any medical reimbursement plan created under Internal Revenue Code Section 105, *including health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs)*.

The Revenue Ruling examined a situation in which an employee purchased non-prescription antacid, allergy medicine, pain reliever, and cold medicine from a pharmacy. All of the products were to be used by the employee and the employee's family, and the employee had not been reimbursed for any of the expenses. Along with the other products, the employee had also purchased non-prescription vitamins.

As part of its Ruling, the IRS stated that non-prescription items that are used to treat personal injuries or to alleviate sickness are reimbursable on a tax-free basis. However, non-prescription dietary supplements like vitamins are not reimbursable on a tax-free basis because they are viewed as merely promoting general health. This new guidance avoids detailed consideration of the term "prescribed drug," but concentrates on the issue of what constitutes an expense for "purposes of medical care." Accordingly, the Ruling states that OTC medicines that are purchased for medical care are reimbursable to employees.

The Ruling contains no specific effective date. Consequently, the Ruling applies immediately (and retroactively). This leaves employers with a few issues to consider:

- If an employer's plan specifically excludes from reimbursement the purchase of OTC medicines and drugs, a decision will need to be made, whether or not to change the current plan provision. If the plan sponsor wants to take advantage of the opportunity to reimburse OTC medications because of Revenue Ruling 2003-102, the plan will have to be formally amended.
- If the plan will be changed to allow reimbursement of non-prescription drugs, employers will need to determine when the change should be made effective and how far back to permit reimbursements.
- If the plan will permit reimbursement for non-prescription drugs, the employer will need to set administrative standards for FSA reimbursements. Plans must still require claim substantiation and would also have the added burden of distinguishing OTC medications from non-reimbursable items.
- Plan sponsors who operate FSAs governed by Plan language authorizing reimbursements for any expense that satisfies IRS reimbursement criteria may wish to consider amending the FSA plan to exclude OTC medications or immediately begin reimbursing as provided by Revenue Ruling 2003-102.

This Ruling will create an additional consideration for group plans facing increasing health care costs. It is also likely that plan sponsors offering FSAs that reimburse OTC medication expenses will now find more participants interested in using FSAs due to the fact that Revenue Ruling 2003-102 should dramatically ease participant fears about forfeiting money under the IRS "use-it-or-lose-it" rule. Moreover, some employers may find themselves pressured by employees to cover OTC drugs since the IRS now permits this reimbursement, and for HRAs, which cannot be funded by employees, the demand for OTC drugs would represent a direct cost to employers. For additional information about FSA reimbursement, please contact your Willis representative.