

IRS Issues New Guidance on Using Debit Cards to Pay for OTC Drugs

Background: IRS Notice 2010-59 regarding the Affordable Care Act specified that, after December 31, 2010, expenses incurred for a medicine or drug could be treated as a reimbursable medical expense under a Health Flexible Spending Account (FSA) only if such medicine or drug is a prescribed drug or insulin, regardless of whether it is available without a prescription. This Notice also stated that health FSA and HRA debit cards could not be used to buy over-the-counter medicines or drugs after January 15, 2011.

Now, the IRS has issued Notice 2011-05, which modifies the debit card rules in Notice 2010-59 so that, after January 15, 2011, health FSA and HRA debit cards may continue to be used to purchase over-the-counter medicines or drugs at drug stores and pharmacies, at non-health care merchants that have pharmacies, at mail order and web-based vendors that sell prescription drugs and at so-called 90 percent pharmacies, provided that the following five requirements are met:

- (1) prior to purchase, (i) the prescription (as defined in Notice 2010-59) for the over-the-counter medicine or drug is presented (in any acceptable format) to the pharmacist; (ii) the over-the-counter medicine or drug is dispensed by the pharmacist in accordance with applicable laws and regulations pertaining to the practice of pharmacy; and (iii) an Rx number is assigned;
 - (2) the pharmacy or other vendor retains a record of the Rx number, the name of the purchaser (or the name of the person to whom the prescription applies), and the date and amount of the purchase in a manner that meets IRS recordkeeping requirements;
 - (3) all of these records are available to the employer or its agent upon request;
 - (4) the debit card system will not accept a charge for an over-the-counter medicine or drug unless an Rx number has been assigned; and
 - (5) the requirements of all other IRS guidance relating to debit cards are satisfied.
- A debit card may be used to purchase OTC drugs or medications from other vendors (meaning vendors other than drug stores and pharmacies, non-health care merchants that have pharmacies and mail order and web-based vendors that sell prescription drugs) only if the vendor has a health care related Merchant Code and if requirements (3) and (5) above are satisfied.
 - A debit card may be used to purchase OTC drugs or medications at “90 percent pharmacies” provided that substantiation is submitted. In general, these are pharmacies with at least 90% of sales attributable to qualified medical care expenses.
 - A debit card may NOT be used after January 15, 2011 to purchase OTC drugs or medications from any other providers and merchants.

These changes will add some additional complexity to the substantiation requirements regarding the purchase of OTC drugs and medications. SBA strongly recommends that you work with your FSA and HRA administrators to confirm their ability to administer these new IRS requirements.

The IRS has stated that it will not challenge the use of debit cards for expenses incurred through January 15, 2011, assuming all other requirements are met. Plan sponsors have until June 30, 2011 to amend their plan documents, so long as the changes are effective retroactively for claims incurred after December 31, 2010, or after January 15, 2011 for debit card purchases.

As a reminder, the OTC regulations apply to medicines and drugs only; equipment, supplies and medical devices can still qualify as reimbursable expenses without a prescription.

Resources

Notice 2011-05: <http://www.irs.gov/pub/irs-drop/n-11-05.pdf>

Notice 2010-59: <http://www.irs.gov/pub/irs-drop/n-10-59.pdf>

IRS website outlining Affordable Care Act Tax Provisions:
<http://www.irs.gov/newsroom/article/0,,id=220809,00.html?portlet=6>

As always, please do not hesitate to contact your SBA consultant with any questions:
http://www.strategicba.com/senior_consulting_team/