CONNER STRONG

Legislative Update

July 22, 2010

Reimbursement Restriction for Over-the-Counter Drugs

Under the new health reform law, over-the-counter (OTC) drugs are no longer qualified for purposes of distributions/reimbursements under health flexible spending arrangements (FSAs), health savings accounts (HSAs), health reimbursement arrangements (HRAs) and Archer medical savings accounts (MSAs), *except for* prescription medicines and insulin. This revenue-raising provision is effective January 1, 2011. Employers that now permit tax-free reimbursements for OTC medicines will most likely need to amend plan documents and communicate changes to plan participants. Coordination with health plan vendors and other relevant third parties may also be necessary.

Since 2003, the law has allowed tax-free reimbursement of expenses for OTC medications without a prescription. The new restriction now means that starting in 2011, expenses for an OTC medication must be prescribed by a physician in order to be eligible for tax-free reimbursement. Insulin is the one exception, qualifying for tax-free reimbursement even without a prescription. This new restriction only affects the status of prescription drugs. It does not affect the other qualified expenses for which reimbursement may be sought, so these accounts will still be permitted to cover vision, dental, and other qualified health care expenses.

Employers will need to address some administrative and implementation considerations when modifying health care plans to comply with the new restriction, such as the application to non-calendar year plans, grace periods for health FSA reimbursements, employee communications, plan amendments, and coordination with plan vendors.

Non-calendar year plan. The employer's plan year is irrelevant as the OTC restriction begins January 1, 2011, regardless of the plan year. So a non-calendar year plan may need to impose two different coverage rules in one plan year (before and after January 1, 2011). Plans that run on a calendar year will face fewer implementation problems, since the coverage change will occur at the start of a new plan year.

Grace periods. Some health FSAs allow participants to incur expenses during a 2-1/2 month grace period after the plan year ends. Employers need to address how this new restriction will affect any part of a grace period that falls after January 1, 2011. Employers might take the position that all non-prescribed OTC drug expenses must be incurred in 2010 to qualify for tax-free reimbursement (non-prescribed OTC drug expenses incurred during a grace period in 2011 won't be reimbursed on a tax-free basis).

Communication. Employers that currently permit tax-free reimbursements for all OTC medications and drugs will need to communicate this change to employees. Summary plan descriptions, claim and enrollment forms, and explanatory materials given to participants in HSAs and MSAs will likely need revising to reflect the new rule. Administrators may want to consider informing participants of the change now in order to give them an opportunity to use their funds to purchase non-prescribed OTC drugs before the new restriction goes into effect.

Plan amendments. Employers that currently reimburse expenses for non-prescribed OTC medications and drugs will need to amend their plan documents for the new restriction and specify whether the plan will reimburse prescribed OTC medications.

Vendor coordination. Employers should clarify with service providers as to which expenses the vendor will reimburse and adjust service agreements to reflect this change. Employers should also coordinate with debit card vendors to be certain that employees won't be able to purchase non-prescribed OTC medications and drugs (except insulin) using debit cards starting in 2011.

Another revenue raising provision in the new health reform law also affects health FSAs. Starting in 2013, health FSA contributions will be limited to a maximum of $2,500 per year (adjusted annually).Traditionally, FSA plans have only been subject to limits imposed by the employer in designing the plan. Many employers allowed elections of up to $5,000 or even more. This new limit of $2,500 will dramatically lower limits in many plans. This new limit is intended as a revenue raiser for the federal government because it will limit the amount of wages an employee may exclude from income and will also raise additional payroll taxes.

As new information is issued on health reform, Conner Strong will issue alerts and updates. Should you have any questions, **please contact your Conner Strong representative toll-free at 1-877-861-3220.**