

OTC Drug Exclusion for FSA/HSA/HRA Plans

Beginning January 1, 2011, OTC drugs may not be purchased using a health FSA, HRA or HSA unless prescribed by a health care provider. For a list of sample expenses that may be reimbursed with a health FSA, HSA or HRA, see the resource “FSA/HSA/HRA Sample Expenses” in the KTB Health Care Reform Center.

Key provisions:

- **Documentation**- employees must submit the prescription or other documentation as well as any other third-party administrator (TPA) documentation required. Many TPA’s will require the participant to complete a Letter of Medical Necessity once every year, which requires the participant’s health care provider to certify that the OTC drug is medically necessary once a year. After the Letter of Medical Necessity is completed and submitted to the TPA, the participant may purchase the OTC drug and submit the expense for reimbursement.
- **Plan Document Requirement**- Plan documents must be updated to include these new restrictions by June 30, 2011, and the amendment must be made retroactive to January 1, 2011.
- **Claim Run-Out/Grace Period**- Many calendar year FSAs allow for a grace period during which claims can be incurred and reimbursed after the end of the plan year. These plans will not be able to reimburse for OTC expenses incurred after January 1, 2011, but may still reimburse for expenses incurred in 2010 even if the request for reimbursement was submitted during the grace period.
- **HSA**- The improper reimbursement of an OTC drug without a prescription by an HSA will be a nonqualified expense. This means that the amount of the reimbursement must be included in the employee’s taxable income and is also subject to the 20% penalty tax. The OTC expense must be incurred in 2010 to be eligible for reimbursement without a prescription.
- **Other OTC Items**- The restrictions do not apply to OTC items other than medicines and drugs (for example, bandages, blood sugar test kits, eyeglasses, etc.)

Additional Resources:

- FSA/HSA/HRA Sample Expenses: <http://ktbenefits.com/hrlibrary/FSA%20HSA%20HRA%20Expenses.pdf>
- IRS Frequently Asked Questions on the OTC exclusion: <http://www.irs.gov/newsroom/article/0,,id=227308,00.html>
- IRS Notice 2010-59: <http://www.irs.gov/pub/irs-drop/n-10-59.pdf>

In response to the Patient Protection and Affordable Care Act and the Health Care and Education Tax Credit Reconciliation Act, collectively known as Health Care Reform, Kistler Tiffany Benefits has formed a Health Care Reform committee to monitor legislation and provide guidance to our valued clients. Our team is creating user-friendly tools and resources, as well as establishing best practices for our clients in regards to the application of this legislation. For more information regarding our services, please contact us at reform@ktbenefits.com.