

## **New Internal Revenue Service Ruling Authorizes Use of Pre-Tax Dollars for Over-The-Counter Medicines**

The Internal Revenue Service recently announced in Revenue Ruling 2003-102 that health flexible spending accounts (“FSAs”) and other employer-sponsored health plans may reimburse properly substantiated expenses for certain over-the-counter medicines and drugs. This is a change from the IRS’ prior position that medicines and drugs are reimbursable only to the extent they would be deductible for tax purposes, which generally meant that only prescription drugs were eligible for reimbursement. (The Ruling is clear that while non-prescription drugs and medicines may now be reimbursed under an FSA or other medical plan, such expenses are still not deductible on an individual’s tax return.)

### **1. Eligible Expenses**

Over-the-counter medicines and drugs are reimbursable only if they are for "medical care." Such drugs include, but are not limited to, antacids, allergy medicines, pain relievers and cold medicines.

Items that are merely beneficial to one’s “general good health,” such as dietary supplements and vitamins, toiletries, and cosmetics, are not considered expenses for medical care and therefore are still not reimbursable.

### **2. Substantiation of Expenses**

Insufficiently documented expenses are not eligible for reimbursement. The Ruling does not specify how eligible expenses must be substantiated in order to be reimbursable. We have been orally advised by the IRS, however, that participants will need to present an original receipt that clearly shows the date the over-the-counter drug was purchased, the type or name of the drug (e.g., Tylenol, Advil, antacid, etc.), and the cost. Handwriting the required information on a receipt or attaching box tops or other product information to the receipt is not acceptable.

### **3. Effective Date**

Since the Revenue Ruling is technically a clarification of the law rather than a new rule, plans that, by their terms, would already permit the reimbursement of over-the-counter drugs, may allow such reimbursement retroactively to the beginning of the current plan year. Plans requiring an amendment to implement the Ruling, however, can be amended to permit such reimbursements prospectively only.

#### 4. Steps for Plan Sponsors

Plan sponsors need to determine whether they want their FSAs or other medical reimbursement plans to cover expenses for eligible over-the-counter medicines. Plan sponsors will then need to review their plan documents to determine whether plan documents need to be revised to reflect their decision.

- Plan sponsors who do wish to provide for the reimbursement of non-prescription drug expenses, but whose plans currently exclude reimbursements for over-the-counter drugs, or only reimburse those expenses that may be claimed as itemized deductions, will need to amend their plans accordingly.
- Plan sponsors who do wish to provide for the reimbursement of non-prescription drug expenses, and whose plans are currently broad enough to provide for such reimbursement without a plan amendment, need only to determine an effective date of the new coverage and communicate the new coverage to participants.
- Plan sponsors who do not wish to provide for the reimbursement of non-prescription drug expenses, but have plans that currently reimburse “expenses for medical care as defined in Section 213(d) of the Code,” or “amounts permitted by the IRS,” with no express exclusion for over-the-counter drugs, will also need to amend their plans accordingly.

Any plan changes need to be communicated to participants.

If you have any questions about how the Revenue Ruling affects your FSA or health plan, or wish to discuss any aspects of the new Ruling, please contact:

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