

IRS Releases Additional Guidance on Use of FSA & HRA Electronic Debit Cards

January 6, 2011

On December 27, 2010, the Internal Revenue Service (“IRS”) released Notice 2011-5, which offers additional scenarios under which an electronic debit card may be used to purchase over-the-counter (“OTC”) medicines or drugs obtained with a prescription, as required under the Affordable Care Act effective January 1, 2011 (a brief transition period exists for debit card purchases between January 1 and January 15, 2011, after which compliance is required).

Notice 2011-5 modifies Notice 2010-59, which changed the IRS definition of “medical expenses,” as the term relates to OTC drugs and medicine. Notice 2010-59 generally provides that, except with respect to expenses incurred at “90 percent pharmacies,” FSA and HRA debit cards cannot reimburse OTC medicines or drugs after January 15, 2011. A “90 percent pharmacy” has at least 90 percent of gross receipts during its prior taxable year consist of items that qualify as expenses for medical care under IRS rules.

Notice 2011-5 modifies Notice 2010-59 such that after January 15, 2011, FSA and HRA debit cards may continue to be used to purchase OTC medicines or drugs at drug stores and pharmacies, at non-health care merchants that have pharmacies and at mail order and Web-based vendors (“Prescription Drug Vendors”), if:

1. Prior to purchase, the prescription for the OTC medicine or drug is presented and an Rx number is assigned;
2. The Prescription Drug Vendor retains a record of the Rx number, the name of the purchaser (or the name of the person for whom the prescription applies), and the date and amount of the purchase;
3. All of these records are available to the employer upon request;
4. The debit card system will not accept a charge for an OTC medicine or drug unless an Rx number has been assigned; and
5. Additional rules regarding the use of FSA or HRA debit cards are satisfied.[\[1\]](#)

If these requirements are satisfied, the debit card transaction will be considered fully substantiated at the time and point of sale.

In addition, after January 15, 2011, health FSA and HRA debit cards may continue to be used to purchase OTC medicines or drugs from non-Prescription Drug Vendors having health care-related “Merchant Codes.” If items 2, 3 and 5 above are satisfied (other than the requirement in #2, above, that a record of the Rx number be retained), these debit card transactions will be considered fully substantiated at the time and point of sale.

Health FSA and HRA debit cards may be used to purchase OTC medicines and drugs at “90 percent pharmacies” but only as provided in Notice 2010-59. (To see our prior Alert on Notice 2010-59, [click here: Changes on Over-the-Counter Drug Coverage Required.](#))

The recent guidance is important in that it provides employees who go to the trouble of obtaining prescriptions for their OTC medicines or drugs with a fairly easy way of using their FSA or HRA debit cards to pay for such medicines or drugs. Employers that want to offer this benefit will need to ensure that their FSA and HRA administrators are working to implement the new rules, and that any additional administrative services that may be necessary as a result of the new rules are appropriately addressed in the service agreement. In addition, Employers may need to amend their cafeteria plans to conform to the new OTC drug requirements. Notice 2010-59 provides that cafeteria plans may be amended retroactively as necessary to comply with these new requirements, provided the amendment is adopted no later than June 30, 2011.

We will continue to update our clients on new developments in this rapidly changing area of the law. In the meantime, please feel free to contact your Proskauer attorney or any member of our Health Care Reform Task Force should you have questions regarding any aspect of health care reform.

[\[1\]](#) See Treasury Regulations Section 1.125-6, Revenue Ruling 2003-43, Notice 2006-69, Notice 2007-2 and Notice 2008-104.