

Health Care Reform Management Alert Series

Issue 4

Flexible Spending Accounts

This is the fourth issue in our health care reform series of alerts for employers on selected topics in health care reform. (Our general summary of health care reform and other issues in this series can be accessed by clicking [here](#).) This series of Health Care Reform Management Alerts is designed to provide a more in-depth analysis of certain aspects of health care reform and how it will impact your employer-sponsored plans.

This issue of the series focuses on two new requirements that will apply to health care flexible spending accounts (FSAs): prohibiting reimbursement of over-the-counter medications obtained without a prescription beginning January 1, 2011 and limiting annual contributions to \$2,500 beginning January 1, 2013.

- ✓ Applies to grandfathered plans
- ✓ Applies to new health plans

Over-the Counter Medications Will Be Reimbursable Only if Prescribed

The Patient Protection and Affordable Care Act (PPACA), as modified by the Health Care and Education Reconciliation Act of 2010 (HCERA) (collectively the "Act") places a new restriction on what can be reimbursed from a health care FSA. Many health care FSAs currently permit reimbursement of expenses for over-the-counter drugs and medications in accordance with a Revenue Ruling released by the IRS in 2003. However, beginning January 1, 2011, health care FSAs will no longer be permitted to reimburse expenses for over-the-counter drugs and medications unless the purchase was obtained by prescription.* The Act did not, however, define what it means for the drug to be a "prescribed" drug.

FSAs will need to cease reimbursing for non-prescribed over-the-counter medications and employers will need to determine whether to continue reimbursing expenses for over-the-counter drugs where prescribed. Health care FSAs will have to be amended accordingly. Employers will also need to work with any service provider to determine how to administer this new restriction.

Employers should note that the change is effective for purchases made on or after January 1, 2011, regardless of whether the plan is administered on a fiscal year or a calendar year basis. Employers should consider notifying participants of this change well in advance of the January 1, 2011 effective date. This is particularly important for non-calendar year plans and for plans that permit participants to be reimbursed for expenses incurred during a grace period in 2011 from contributions made in 2010, so that there will be no surprises in 2011.

*Please note that the same limitation on reimbursement of non-prescribed over-the-counter medications will also apply to health reimbursement arrangements (HRAs), health savings accounts (HSAs) and Archer medical savings accounts (Archer MSAs) beginning January 1, 2011.

Annual FSA Contributions Limited to \$2,500

Currently, employers are free to decide, on an annual basis, what limit to set on employee contributions to a health care FSA. Beginning January 1, 2013, however, the Act will require health care FSA contributions be limited to no more than \$2,500 per year. The \$2,500 limit will increase in taxable years beginning after December 31, 2013, based on increases in the Consumer Price Index (CPI).

Because the new limit is tied to the taxable year of the participant (which is the calendar year), employers with health care FSAs that use a non-calendar plan year and generally permit contributions of more than \$2,500 will need to determine how to comply with the new limitation during the transition year that begins in 2013. This could mean setting a \$2,500 limit for the plan year that begins in 2012 or bifurcating the 2012-2013 plan year contributions to limit the amount contributed after December 31, 2012 to no more than \$2,500 on an annualized basis.

Employer Action Plan

- Determine whether you will continue reimbursing expenses for prescribed over-the-counter drugs and medications and amend your health care FSA plan and SPD accordingly.
- For employers that decide to continue reimbursing expenses for over-the-counter drugs and medications, determine how to administer the new prescription requirement.
- Inform employees of the new prescription requirement well in advance of January 1, 2011 so that they can plan their 2010 year-end spending.
- Amend your health care FSA plan and SPD for compliance with the new \$2,500 limit by December 31, 2012.

For further details, or if you have any questions regarding the new health care FSA requirements, contact your Seyfarth Shaw LLP attorney or any Employee Benefit attorney listed on the website at www.seyfarth.com/employeebenefits, or send your questions to HealthReform@seyfarth.com.



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