



Fine Print

A Quarterly Publication of the Ohio State Bar Association
and Our Members

Issue 20 • Summer 2004

OVER-THE-COUNTER DRUGS COVERED BY HEALTH CARE FLEXIBLE SPENDING ACCOUNTS

By Jason Rothman

The Treasury Department and the IRS issued a ruling, effective beginning in 2003, stating that over-the-counter drugs can be paid with pre-tax dollars through health care flexible spending accounts (“health FSAs”). As a result of this ruling, employees now can exclude employer reimbursements for non-prescription medications from their gross income for tax purposes.



Under current tax law, as under the old law, taxpayers are not required to consider reimbursements of prescription medical expenses for themselves or their dependents as gross income. However, under the old law, reimbursements for over-the-counter expenditures could not be excluded from gross income. As a result of the new ruling, an employee can now exclude employer-reimbursed expenses for both prescription and non-prescription medications from gross income for tax purposes, as long as these expenses are substantiated.

The ruling states that antacids, allergy medicine, pain relievers, and

cold medicine purchased without a physician’s prescription are considered expenditures for medical care.

Therefore, an employee’s expenditure for these items may be reimbursed under an employer’s health FSA and excluded from the employee’s gross income. However, the ruling does not cover the purchase of dietary supplements, which are considered “merely beneficial”

to a person’s general good health and therefore, cannot be reimbursed or excluded from gross income.

The IRS made this ruling in response to the increasing availability of non-prescription drugs. This has caused concern because, while over-the-counter drugs are generally less expensive than prescription drugs, the actual cost of over-the-counter drugs to most consumers is often greater than the consumer’s copayment for prescription drugs covered by insurance. This ruling will result in savings to consumers with access to health FSAs who purchase over-the-counter drugs.

The principles of the ruling apply
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HEALTH REIMBURSEMENT ARRANGEMENTS (HRAs)

By Jason Rothman

In 2002, the IRS sanctioned a plan for reimbursing employee and dependent medical expenses called a “Health Reimbursement Arrangement” (“HRA”). An HRA is an arrangement that: (1) is paid for solely by the employer (it cannot be paid for by reducing employees’ salaries or through a Section 125 cafeteria plan); (2) reimburses the employee for his or her own medical care expenses and those of the employee’s spouse and dependents; and (3) provides reimbursements up to a maximum dollar amount for a plan year.

The following highlights significant characteristics of HRAs.

■ An employee who is covered by an HRA may exclude reimbursed expenses from his or her gross income. Also, the employer’s contributions to an HRA are tax deductible.

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to all types of employer-sponsored benefit plans that provide pre-tax health care benefits. Therefore, this ruling applies to HRAs and self-insured medical reimbursement plans.

There are a few issues that employers must consider before reimbursing employees for purchases of over-the-counter drugs. First, an employer may have to amend its plan documents to allow such reimbursements. Second, since plan participants must substantiate their expenses for medical care, necessary changes in administrative procedures may raise the cost of the plan. Finally, due to the broad definition of "medicine and drugs" and lack of clear IRS guidance, plans should adopt specific definitions as to what constitutes a medicine or drug.

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■ An HRA must be paid only with employer dollars and cannot be paid for through employee salary reductions.

■ An HRA may only be used to reimburse employees for medical expenses.

■ HRAs allow the unused portion of plan coverage to be carried over to subsequent plan years without limitation, as opposed to health care flexible spending accounts (FSAs) that are subject to the use-it-or-lose-it rule (i.e., amounts not used at the end of a plan year are forfeited).

■ An HRA may cover current and former employees (including retirees) and their spouses and dependents. A surviving spouse and dependents may also be covered.

■ HRAs may be provided to cover expenses not covered under the employer's customary group health plan (such as physician co-pays, vision

HRAs allow employers to lower their rates while getting the quality of care that only larger groups usually can provide.

exams, and over-the-counter drugs).

■ Employers may provide both an FSA and an HRA. The same expense

cannot be reimbursed under both the HRA and the FSA.

■ Employers must comply with various federal laws including ERISA, HIPAA, COBRA, and IRS non-discrimination rules when providing HRAs.

Employers who want to provide medical coverage to employees on a tax-advantaged basis should consider an HRA. HRAs allow employers to lower their rates while getting the

quality of care that only larger groups usually can provide, while enabling employees to accumulate money for future health care needs such as retirement health care expenses and dependent claims (even after death). Employers looking to adopt an HRA plan should carefully consider all the requirements noted above, especially if they wish to offer an HRA in addition to a cafeteria plan that offers an FSA.

HRA plan documents will need to be carefully drafted to meet these requirements.

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IN THE HOPPER

Pending state legislation that could affect small business

Substitute House Bill 223, effective October 13, 2004, specifies when employee drug testing may establish a "rebuttable presumption" that an employee's injury was essentially caused by the use of illegal drugs or alcohol.

House Bill 38, which became effective on June 17, 2004, specifically prohibits the unauthorized practice of law by those who perform a service for pay without a required license, certificate, permit or registration, and establishes procedures for a cease and desist order and damages.

From the OSBA Office of Government Relations.

Web site resource for small businesses:

To learn about programs offered by the U.S. Dept. of Labor's Office of Small Business, go to: <http://www.dol.gov/osbp>.



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