

# Employee Benefits Briefing

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A bulletin designed to keep clients and other friends informed on employee benefits law matters

September 2003

## NONPRESCRIPTION DRUGS NOW REIMBURSABLE UNDER FLEXIBLE SPENDING ACCOUNTS

In a dramatic about-face, the Internal Revenue Service has reversed its long-held position that nonprescription drugs cannot be paid for with pre-tax dollars from health care flexible spending accounts. In an IRS Revenue Ruling released on September 3, 2003, the IRS ruled that over-the-counter medicines generally *are reimbursable* from health care flexible spending accounts. The IRS also ruled for the first time that employer-sponsored group health plans may cover nonprescription drugs without reimbursement for those expenses being treated as taxable income to the employee.

The ruling is effective immediately and is likely to generate significant interest among employees and retirees. Accordingly, employers will need to review their current health plan documents to determine the immediate effect of the ruling, what plan design and administration changes should be made, if any, and what communications should be prepared and distributed to participants.

The factual backdrop for the IRS's change of position involved a participant's purchase of an antacid, an allergy medicine, a pain reliever, a cold medicine and vitamins, none of which were purchased with a prescription. The IRS stated that the cost of the antacid, allergy medicine, pain reliever and cold medicine are reimbursable from a health care flexible spending account because they are used to alleviate or treat sickness or injury. In contrast, the vitamins are not reimbursable because, according to the IRS ruling, they are merely beneficial for general good health.

The IRS's new analysis distinguishes between those medical expenses that are deductible under Section 213(d)(1) of the Code, and those for which reimbursements from employer health plans, including health care flexible spending accounts, are excluded from the income of the employee or retiree for income tax purposes. The latter category, according to the IRS, is not limited to prescribed drugs. Therefore, over-the-counter medications used for the "diagnosis, cure, mitigation, treatment or prevention of disease" are subject to the same treatment as prescription drugs for purposes of reimbursement by health care flexible spending accounts and other employer health plans.

The IRS's news release accompanying the Revenue Ruling stressed that the change in position acknowledges that many drugs that used to be prescription-only are now available without a prescription and that many individuals remedy chronic health problems by regularly taking nonprescription medicines.

As noted above, employers will need to review their health benefits plan documents and participant communications to determine what actions need to be taken in light of this new IRS ruling. For assistance, contact any member of Vedder Price's Employee Benefits Group listed at the end of this Bulletin or any other Vedder Price attorney with whom you have worked.

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Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars. Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their sponsors. Our clients include large national corporations, smaller professional and business corporations, multi-employer trust funds, investment managers and other plan fiduciaries.

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