

Part III - Administrative, Procedural, and Miscellaneous

Section 105 - Amounts Received under Accident and Health Plans, Section 106 – Contributions by Employers to Accident and Health Plans, Section 125 – Cafeteria Plans

Notice 2011-5

I. PURPOSE AND BACKGROUND

.01 This notice modifies Notice 2010-59, 2010-39 IRB 396. Notice 2010-59 provides guidance on § 9003 of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, which added section 106(f) to the Internal Revenue Code. Section 106(f) revises the definition of medical expenses for employer-provided accident and health plans, (including health flexible spending arrangements (health FSAs) and health reimbursement arrangements (HRAs)) and for Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (Archer MSAs). The notice explains that, after December 31, 2010, expenses incurred for a medicine or a drug shall be treated as a reimbursement for a medical expense only if such medicine or drug is a prescribed drug (determined without regard to whether such drug is available without a prescription) or is insulin. Notice 2010-59 also provides that, except with respect to “90 percent pharmacies,” health FSA and HRA debit cards may not be used to purchase over-the-counter medicines or drugs after January 15, 2011.

.02 Additional rules for the use of health FSA or HRA debit cards are set forth in Prop. Treas. Reg. § 1.125-6 and in Rev. Rul. 2003-43, 2003-1 C.B. 935;

Notice 2006-69, 2006-2 C.B. 107; Notice 2007-2, 2007-1 C.B. 254; and Notice 2008-104, 2008-2 C.B. 1298.

II MODIFICATIONS TO NOTICE 2010-59

After January 15, 2011, health FSA and HRA debit cards may continue to be used to purchase over-the-counter medicines or drugs at drug stores and pharmacies, at non-health care merchants that have pharmacies and at mail order and web-based vendors that sell prescription drugs, if: (1) prior to purchase, (i) the prescription (as defined in Notice 2010-59) for the over-the-counter medicine or drug is presented (in any format) to the pharmacist; (ii) the over-the-counter medicine or drug is dispensed by the pharmacist in accordance with applicable law and regulations pertaining to the practice of pharmacy; and (iii) an Rx number is assigned; (2) the pharmacy or other 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 in a manner that meets IRS recordkeeping requirements¹; (3) all of these records are available to the employer or its agent upon request; (4) the debit card system will not accept a charge for an over-the-counter medicine or drug unless an Rx number has been assigned; and (5) the requirements of the guidance referred to in paragraph I.02 of this notice are satisfied. If these requirements are met, the debit card transaction will be considered fully substantiated at the time and point-of-sale.

¹ Section 6001 requires taxpayers to maintain records and to substantiate all positions and amounts reflected on returns. Rev. Proc. 98-25, 1998-1 CB 689, contains detailed rules for taxpayers with automated systems (e.g., requiring IRS access to all electronic records used to prepare returns, and that records must be in format readable by IRS). Also, Prop. Treas. Reg. § 1.125-6 describes the requirements for substantiating, paying and reimbursing expenses for § 213(d) medical care when payment is made with a debit card and incorporates previously issued guidance on the requirements.

After January 15, 2011, health FSA and HRA debit cards may also continue to be used to purchase over-the-counter medicines or drugs from vendors (other than drug stores and pharmacies, non-health care merchants that have pharmacies, and mail order and web-based vendors that sell prescription drugs) having health care related Merchant Codes, as described in Rev. Rul. 2003-43, 2003-1 C.B. 935, if all requirements in the preceding paragraph are satisfied, other than the requirements in clause (1) and clause (4) of the preceding paragraph and the requirement in clause (2) of the preceding paragraph that a record of the Rx number be retained. If these requirements are satisfied, 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 over-the-counter medicines and drugs at “90 percent pharmacies” but only as provided in Notice 2010-59.

For all other providers and merchants, other than those described in this notice, health FSA and HRA debit cards may not be used to purchase over-the-counter medicines or drugs after January 15, 2011.

III. EFFECTIVE DATE

This notice is effective for health FSA and HRA debit card purchases of over-the-counter medicines or drugs made after January 15, 2011.

IV. EFFECT ON OTHER DOCUMENTS

This notice modifies Notice 2010-59, 2010-39 IRB 396 (September 27, 2010) as it applies to the use of health FSA and HRA debit cards to reimburse expenses for over-the-counter medicines or drugs. IRS and Treasury intend to amend the regulations at § 1.125-6 to reflect the provisions of this notice. Taxpayers may rely on this notice pending the issuance of the amended regulations.

DRAFTING INFORMATION

The principal author of this notice is Robin Ehrenberg of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this Notice, contact Ms. Ehrenberg at (202) 622-6080 (not a toll-free call).