

Publications

IRS Revenue Ruling Allowing Health Plans to Reimburse Nonprescription Medicine and Drugs

ATTORNEYS & PROFESSIONALS

Christine Keller

ckeller@groom.com

202-861-9371

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Author: Mike Thrasher

In Rev. Rul. 2003-102, the IRS takes the position that medicine and drugs do not have to be prescribed by a physician to be considered reimbursable medical expenses under a health flexible spending arrangement or other employer-sponsored health plan. Prior to this ruling, the widely-held view — and IRS informal position — was that, to be reimbursable from a health flexible spending arrangement (“FSA”) or other employer-sponsored medical plan, a medicine or drug had to be prescribed by a physician. However, the IRS has now clarified that health FSAs may reimburse medicine and drug expenses procured without a prescription. Although the fact pattern in the Revenue Ruling involves a health FSA, the reasoning is broad enough to extend to all types of employer sponsored group health plans.

The Revenue Ruling explains that section 105(b) of the Code, which allows employees to exclude employer reimbursements for medical expenses from income, does not cross reference section 213(b) of the Code, which limits the definition of medical expenses to prescribed medicine or drugs, or insulin. Instead, section 105(b) cross references the general definition of medical expenses found in section 213(d). Accordingly, the Revenue Ruling concludes that the prescription limitation of section 213(b) is applicable only to medical expense deductions, and not to employer reimbursements from health FSAs or other employer-sponsored health plans.

The Revenue Ruling generally gives employers the flexibility to adopt plan provisions that allow employees to receive reimbursements for nonprescription drugs and medicine on a tax-free basis. The only significant downside is that there is now likely to be some uncertainty concerning what constitutes a drug or medicine. Existing IRS guidance is not helpful, as it merely states that the term “medicine and drugs” includes only items that are legally procured and generally accepted as falling within the category of medicine and drugs. The Revenue Ruling identifies four types of over-the-counter drugs that satisfy the definition of medicine and drugs: an antacid, an allergy

medicine, a pain reliever, and a cold medicine. In addition, the Revenue Ruling states that dietary supplements (vitamins) that are used to maintain general good health do not satisfy the definition of medical expenses. However, many questions concerning whether an item satisfies the definition of a medicine or drug are likely to arise. For clarity in administration, plans should adopt specific definitions of what constitutes a medicine or drug, and what limitations, if any, will be placed on the purchase of such items (e.g., excluding items purchased for anticipated personal injuries or sickness). In addition, in certain cases it may be advisable for employers to obtain specific guidance from the IRS, either on an informal basis, or in the form of a private letter ruling.

Because Rev. Rul. 2003-102 is viewed by the IRS as an interpretation of existing law, it is arguably retroactively effective to the beginning of the plan year and would allow reimbursement of covered expenses previously incurred. However, employers may have to amend their plans before implementing this change (e.g., if the plan specifically states that nonprescription drugs are not reimbursable). In addition, changes in administrative procedures and possibly claim forms may be needed. For these reasons, we would expect most employers that wish to cover these items will wait until 2004 to do so.

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