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An Update From Bodman PLC

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Modification of the Treatment of Over the Counter Medical Products as Qualified Medical Expenses

As previously described here, the CARES Act Section 3702 eliminated the requirement to have a prescription for over the counter (OTC) drugs and added menstrual care products (MCP) as items that would qualify for tax favored reimbursement from health savings accounts (HSA), Archer medical savings accounts (Archer MSA), health reimbursement accounts (HRA), and health flexible spending arrangements (FSA). The following Q&As are intended to address some questions that have arisen regarding this change.

Q-1: What is the effective date of the change?

A-1: The change applies to amounts paid from an HSA or Archer MSA after December 31, 2019. For FSAs and HRAs, the change applies to expenses incurred after December 31, 2019. Accordingly, this provision is currently effective.

Q-2: Are the changes in Section 3702 effective for only as long as the COVID-19 crisis exists or are they permanent?

A-2: Permanent. Making MCP eligible for tax-favored reimbursement is new. Section 3702 essentially restores pre-Affordable Care Act (ACA) rules for OTC drugs.

Q-3: Is this change mandatory or optional for FSAs and HRAs?

A-3: Optional. There is no requirement that these arrangements be designed to cover all qualified medical expenses (QME). Accordingly, the sponsor could decide to include or exclude coverage for OTC drugs or MCP.

Q-4: Must the arrangement be amended to allow tax-favored reimbursement of OTC drugs or MCP?

A-4: It depends on the terms of the plan documents associated with the FSA or HRA. The plan documents should be reviewed to assess what amendments, if any, would be necessary.

An FSA or HRA that incorporated the statutory definition of QME by reference may not need to be amended. The change may be automatic due to the change made by Section 3702 to the statute. If the plan documents incorporated the definition of QME by reference and if the sponsor wanted to exclude coverage for OTC drugs or MCP, an amendment may be required to exclude coverage for OTC drugs or MCP.

If the FSA or HRA did not incorporate the statutory definition of QME by reference or if the plan's definition of QME excluded OTC drugs, an amendment would likely be necessary. Since MCP is newly eligible as a QME, the plan would likely have to be amended if it did not incorporate the statutory definition of QME.

Given the nature of HSAs and Archer MSAs, it is unlikely that amendments to the accounts would be necessary.

In addition to possible plan amendments, the expanded coverage of OTC drugs and MCP would have to be communicated to employees. Sponsors will have to coordinate with administrators and vendors to ensure that their systems can accommodate the changes brought about by Section 3702.

Q-5: Are the pre-ACA rules applicable to OTC drugs effective once again?

A-5: No. Section 3702 did not restore the pre-ACA guidance with respect to OTC drugs which provided that drugs purchased to alleviate or treat personal injury or sickness were eligible expenses. See Rev. Rul. 2003-102. With that said and absent current guidance, there is nothing which would prohibit the old guidance from being used as a framework for purposes of making plan design decisions and working with vendors to make this benefit effectively available.

Q-6: We have a calendar year FSA plan and want to implement the changes made by Section 3702 immediately. The FSA is funded with employee contributions via a cafeteria plan. Will this change allow participants to modify their cafeteria elections mid plan year to take advantage of the expanded scope of QMEs?

A-6: Absent additional guidance, participants would not be able to modify their existing cafeteria elections. Cafeteria elections can only be modified upon the occurrence of certain specified events, provided the cafeteria plan document reflected the election change rule. Even then, not all events will permit a change to the FSA. In this case, the expansion of items considered to be QMEs would not allow change in the FSA election. The participants would nevertheless be able to use their FSA to pay for OTC drugs or MCP. They just would not be able increase or decrease the amounts being allocated to the FSA as a result of this change.

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