

COMPLIANCE OVERVIEW



Reimbursable OTC Items for Health FSAs, HRAs and HSAs

Health flexible spending accounts (FSAs), health reimbursement arrangements (HRAs) and health savings accounts (HSAs) may provide tax-free reimbursements of certain over-the-counter (OTC) items. OTC items are those that are generally available to consumers without a prescription.

To be reimbursable, an OTC item must be for "medical care," as defined under Internal Revenue Code (Code) Section 213(d). Medical care expenses are amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting a structure or function of the body.

Under the Affordable Care Act (ACA), health FSAs, HRAs and HSAs needed a prescription to reimburse the costs of OTC medicine or drugs (except for insulin) on a tax-free basis. However, on March 27, 2020, President Trump signed the [Coronavirus Aid, Relief and Economic Security Act](#) (CARES Act) into law to address the COVID-19 crisis. **Effective Jan. 1, 2020, the CARES Act allows OTC drugs, along with menstrual care products, to be treated as qualified medical expenses that may be paid for using these tax-advantaged arrangements.**

LINKS AND RESOURCES

- [Code Section 213\(d\)](#) contains the federal definition of "medical care."
- [IRS information letter from 2009](#) addresses whether certain OTC items qualify as medical care expenses.
- The [CARES Act](#) allows OTC drugs and menstrual care products to be treated as qualified medical expenses.

OTC Items – Medical Care

- Payments for medicine and drugs qualify as medical care expenses, regardless of whether the item is available without a prescription (that is, an OTC item).
- Expenses for OTC items (other than medicines or drugs) may qualify as medical care only if they are "primarily for" the prevention or alleviation of a physical or mental defect or illness.

The CARES Act

- The CARES Act treats OTC drugs and menstrual care products as qualifying medical expenses that may be paid for (or reimbursed) on a tax-free basis by an HSA, health FSA, or HRA.
- This change eliminates an ACA provision that required individuals to have a prescription for an OTC drug (except insulin) to pay for it on a tax-free basis with their HSA, health FSA, or HRA.

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Medical Care Expenses

To be reimbursable, an OTC item must be for “medical care,” as defined under Code Section 213(d). Medical care expenses are amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting a structure or function of the body.

Payments for medicine and drugs qualify as medical care expenses, regardless of whether the item is available without a prescription (that is, an OTC item) or requires a prescription. However, only items that are legally procured and are generally accepted as being medicine and drugs qualify as reimbursable medical care expenses. This would not include, for example, toiletries, cosmetics or sundry items.

Expenses for OTC items (other than medicines or drugs) may qualify as medical care only if they are “primarily for” the prevention or alleviation of a physical or mental defect or illness. Expenses that merely benefit general health, on the other hand, are considered personal expenses and will not qualify as medical care expenses.

Plan Design Tip: Employers that sponsor health FSAs or HRAs for their eligible employees may design their plans to define the medical care expenses that are eligible for reimbursement more narrowly than what is permitted under Code Section 213(d) or the CARES Act. For example, some employers may exclude certain expenses that are difficult to administer, such as specific OTC items, even when those items may qualify as “medical care expenses” under IRS guidelines.

Medical Care Factors

Whether an otherwise personal expense is primarily for medical care is a question of fact. Several objective factors may be considered in making this determination, including:

- The motive or purpose for making the expenditure;
- Whether a physician has diagnosed a medical condition and recommended the item as treatment;
- The link between the treatment and the illness;
- Treatment effectiveness; and
- The proximity in time to the onset or recurrence of a disease.

The “But For” Test

For the expense to be deemed medical care, it must be established that the expense would not have been paid “but for” the disease or illness. That is, the item is not for medical care if the individual would have paid for it even without a medical condition.

Personal and Medical OTC Items

An IRS [information letter](#) from 2009 specifically addresses a number of items (other than medicine or drugs) that may be both personal and medical in nature, as well as items that are generally used only for medical care.

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Personal Items as Medical Care

Certain items may qualify as medical care, or may be personal items, depending on how they are used. For example, a person may use these items to maintain general health, or as toiletries or cosmetics (such as face creams, deodorants, perfumes, shampoos or toothpaste). These are personal uses. However, if it can be shown that the item is used to treat or alleviate a disease or injury, and satisfies the “but for” test, the item may qualify as a medical care expense.

Medical Care Only Items

Items that have no purpose other than to treat a disease, illness, or mental or physical defect may qualify as medical care. Treatments for the following conditions will most likely qualify as medical care:

- Acne;
- Incontinence;
- Arthritis;
- Constipation;
- Colds and sinus problems;
- Dehydration; and
- Indigestion.

In addition, the following items will probably qualify as medical care:

- Support braces and shoe inserts for injured or weakened body parts;
- Products that have no purpose but to treat existing skin conditions such as eczema (as opposed to products that are designed to prevent the development of the condition); and
- Wheelchair cushions that are a necessary accessory to a wheelchair.

Excess Cost of Personal Items

The excess cost of an otherwise personal item that is specially designed to treat or alleviate a medical condition, over the cost of the item without the special features, may be considered an expense for medical care. For example, the cost of specially designed clothing that is used to treat a specific disease, such as diabetic socks, compression hose or orthopedic shoes that exceeds regular clothing may be a medical care expense. However, these items may also be used for personal or preventive reasons. Whether they are eligible for reimbursement will depend on the facts of each specific case.

Special Foods

The cost of food is not a medical care expense if it is a substitute that a person would normally consume to meet nutritional requirements. However, it is possible that the cost of special foods will qualify as a medical care expense if the food is necessary to cure or treat a specific illness and it is not a part of the person’s normal nutritional needs. This is a question of fact that must be determined on a case-by-case basis. Also, there is some legal uncertainty regarding whether the additional cost of foods that have been modified for special diets (for example, gluten-free) is a medical care expense.

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Changes Made by the CARES Act

Effective Jan. 1, 2020, the CARES Act treats all OTC drugs and medicines as qualifying medical expenses that may be paid for (or reimbursed) on a tax-free basis by an HSA, health FSA or HRA. This change eliminates the ACA provision that required individuals to have a prescription for an OTC medication (except insulin) to pay for it on a tax-free basis with their HSA, health FSA or HRA.

In addition, effective Jan. 1, 2020, menstrual care products are qualifying medical expenses that can be paid for (or reimbursed) on a tax-free basis by an HSA, health FSA or HRA. Menstrual care products include tampons, pads, liners, cups, sponges or similar products used by individuals with respect to menstruation.