

IRS News Release

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Over-the-Counter Drugs To Be Covered by Health Care Flexible Spending Accounts

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WASHINGTON — Today, the Treasury Department and the IRS announced over-the-counter drugs can be paid for with pre-tax dollars through health care flexible spending accounts. Treasury and IRS issued guidance clarifying that reimbursements for nonprescription drugs by an employer health plan are excluded from income. Thus, reimbursements by health flexible spending arrangements (FSAs) and other employer health plans for the cost of over-the-counter drugs available without prescription are not subject to tax if properly substantiated by the employee.

"Flexible Spending Accounts are an important tool in helping people meet their health care costs," stated Treasury Secretary John Snow. "Since many prescription drugs have moved to the over-the-counter market, this action today makes paying for them a little bit easier to swallow."

"Flexible Spending Accounts were established under the tax code to provide incentives for better health care," said IRS Commissioner Mark W. Everson. "This action is a sensible expansion and simplification of the program consistent with existing law."

Drugs are increasingly becoming available over-the-counter without prescription. Many health plans no longer cover the cost of these drugs as over-the-counter. While an over-the-counter drug is less expensive than the prescription drug, the cost to many consumers increases because the price paid by the consumer for the over-the-counter drug is greater than the co-payment by the consumer when the drug was covered by insurance. This is especially an issue for individuals who remedy chronic health problems by regularly taking an over-the-counter medicine.

Revenue Ruling 2003-102 explains that the statutory exclusion for reimbursements of employee health expenses is broader than the itemized deduction for medical expenses (which does not apply to nonprescription drugs). Thus, the guidance clarifies that employer reimbursements of employee health expenses that are nonprescription drugs, including reimbursements through health FSAs and Health Reimbursement Arrangements (HRAs), are excluded from income like other employer reimbursements of employee health expenses. This will result in savings to consumers with access to employer plans who may purchase nonprescription drugs.

However, for purposes of the itemized medical expenses deduction, the cost of such over-the-counter drugs continues to be non-deductible. In addition, the cost of dietary supplements that are merely beneficial to the employee's health are not excluded from income.

Rev. Rul. 2003-102 will be published in Internal Revenue Bulletin 2003-38, dated Sept. 22, 2003. It is available on the IRS Web site at www.irs.gov.

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