



Legislative Brief

Health Care Reform: Changes to Health Accounts



EXECUTIVE SUMMARY

The health care reform law, which consists of the Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010 (HCERA), makes some significant changes to accounts such as health flexible spending accounts (health FSAs) and health savings accounts (HSAs). These include:

- Reimbursement permitted for medicine or a drug only with a prescription (except for insulin).
- Contributions to health FSAs limited to \$2,500 per year, subject to cost-of-living increases.
- Increased tax on withdrawals from HSAs and Archer MSAs not used for medical expenses.

This Commonwealth Insurance Group, LLC Legislative Brief describes the new rules related to these accounts and when the changes take effect. Please read below for more information and contact Commonwealth Insurance Group, LLC with any questions.

EXPLANATION OF CHANGES

Limits on Reimbursement of Over-the-Counter Medications

The health care reform law has revised the definition of “qualified medical expenses” for purposes of reimbursement from health FSAs and health reimbursement arrangements (HRAs), and distributions from Archer medical savings accounts (Archer MSAs) and HSAs. The new definition is consistent with the definition used for the itemized tax deduction.

Under the new definition, qualified medical expenses include amounts paid for medicines or drugs **only if the medicine or drug is a prescribed drug** (determined without regard to whether the drug is available without a prescription) or is insulin.

This means that health FSAs and HRAs may not reimburse the cost of over-the-counter medications that do not have a prescription. Also, distributions from Archer MSAs and HSAs used to pay for over-the-counter medications without a prescription will be taxable and subject to penalties. However, amounts paid for over-the-counter medicine with a prescription still qualify as medical expenses.

The limits on over-the-counter medications for health FSAs and HRAs are effective for expenses incurred with respect to **taxable years beginning after December 31, 2010**. For HSAs and Archer MSAs, the limits are effective for amounts paid with respect to **taxable years beginning after December 31, 2010**.

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Limits on Health FSA Contributions

Many employers choose to limit the amount that employees may contribute to a health FSA each year, but there is no federal limit on contributions. However, beginning in 2013, a health FSA offered through a cafeteria plan will have to limit the amount of salary reduction contributions that employees can make. Effective for **taxable years beginning after December 31, 2012**, employees may not elect to contribute more than **\$2,500 per year** to a health FSA. This amount will increase in future years to reflect cost-of-living increases.

Increased Tax on Withdrawals from HSAs and Archer MSAs

Participants in HSAs and Archer MSAs may withdraw funds from those accounts either to pay for qualified medical expenses or to use for other purposes. However, only withdrawals used to pay for qualified medical expenses are tax-free. If the funds are used for other purposes, the withdrawal becomes taxable and subject to penalties.

The health care reform law increases the additional tax on HSA distributions prior to age 65 that are not used for qualified medical expenses from 10 to **20 percent**. The additional tax for Archer MSA distributions not used for qualified medical expenses increases from 15 to **20 percent**. The increased taxes apply to distributions from these accounts made after **December 31, 2010**.

LEGISLATIVE REFERENCES

For more information on these topics, see the following sections of the health care reform legislation:

- Limits on Reimbursement of Over-the-Counter Medications: **PPACA §9003**
- Limits on Health FSA Contributions: **PPACA §9005, §10902; HCERA §1403**
- Increased Tax on Withdrawals from HSAs and Archer MSAs: **PPACA §9004**

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