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NEW DEVELOPMENTS IN FLEXIBLE SPENDING ACCOUNTS OPEN OPPORTUNITIES

Paying For OTCs With Pre-Tax Dollars

THE ISSUE

The IRS rules regarding healthcare flexible spending accounts, better known as FSAs, changed in Sept. 2003, so that certain over-the-counter (OTC) medicines can now be covered by these programs. This opens up human resource opportunities within every GMDC member company. In addition, the new ruling creates marketing opportunities for GMDC Wholesaler/Retailer members and the specific member companies that manufacture and distribute OTC products covered by FSAs.

FSAs are voluntary programs many employers use to allow their employees to set aside money every year to pay for certain medical expenses not covered by insurance; this money does not get taxed. According to this new ruling—[IRS Revenue Ruling 2003-102](#)—employees now can pay for certain OTC medicines with the pre-tax dollars from their FSAs. The medicines included are those used to alleviate or treat personal injuries or sickness. Examples would be such categories as cough/cold/allergy, analgesics (internal and topical), gastrointestinal, first aid/topicals, ophthalmics, smoking cessation, oral discomfort, and antifungals. Dietary supplements, including vitamins, minerals, herbals, and botanicals, are covered when used to treat a current illness, but not when used for general health purposes. However, items used for “general health,” such as toiletries (i.e., toothpaste), cosmetics (i.e., face creams), and related items will not be eligible for reimbursement.

BACKGROUND

According to the Employers Council on Flexible Compensation (ECFC), approximately 22.5 million workers have access to reimbursement accounts, and about 20-30% of those participate in FSAs, equal to around 4.5-6.8 million workers. Overall, FSAs are used for such products and services as co-pays and deductibles (physicians visits), contact lenses, eyeglasses, dental care, hearing aids, flu shots, prescription drugs, medical devices and now OTC medications.

As good as FSAs are, every year many employees lose money with them. This is because FSAs are a use-it-or-lose-it program. If an employee fails to spend all the money in an FSA by the end of the year, that money is lost and returns to the employer. According to a human resources firm, the median amount lost by consumers is \$100. However, since this ruling allows employees with FSAs to use OTC medicine receipts dating back to Jan. 1, 2003, it may provide employees with FSAs the immediate option of using OTC medicine receipts to ensure they break even this year, using their FSAs to maximum benefit.

In the future, employees with FSAs that include OTC coverage can budget for their healthcare needs with OTC medicines in mind. Many Americans use many OTC therapies each year to treat common ailments and chronic diseases. Now, those employees may be able to use their FSAs for those expenses for themselves and their families, feel better, and save money. In addition, employees who do not currently participate in their companies' FSAs may want to join.

OPPORTUNITIES

Opportunities for All Companies All GMDC member companies have a human resources opportunity by making available a health benefit that will lower the cost for obtaining important medicines commonly used to treat or alleviate injuries or sickness. In an era of declining coverage and increasing costs in healthcare, the expansion of products and services included within FSAs is a positive step in providing employees better coverage while controlling their healthcare costs.

Opportunities for Wholesaler/Retailer Members A significant immediate and ongoing sales and profit opportunity may exist for both retailers and wholesalers through promoting the new IRS ruling to their customers. At this time of year, many consumers will have excess money left in their accounts and many more may be budgeting for their 2004 FSA programs. Promoting the eligibility of OTCs for use with FSAs may prompt increased sales this year as consumers try to break even on their accounts, and in the future as consumers focus on their OTC purchases. The retail industry will benefit from these purchases and is in a unique position to execute a variety of promotions (e.g., loyalty cards, circulars, in-store media, and direct-mail coupons) targeted at the millions of FSA participants. Ultimately, this will drive increased store traffic and sales of OTCs and other products, as well as foster goodwill among the consumers served.

Opportunities for OTC Suppliers Manufacturers of eligible OTCs will be in a position to develop sales for their products, particularly Rx-to-OTC switch items, for which consumers will now have a reimbursement opportunity not present previously, frequently an issue for those who have been using such products for chronic care. The ruling's potential for cost reduction will stimulate consumer purchasing of covered OTCs and conceivably the entire HBC department. It is important that OTC suppliers develop programs that will effectively support retailers and wholesalers in their endeavors to leverage the new ruling. Consumer advertising on behalf of this ruling may be an option.

ACTION STEPS

There are important administrative issues to be addressed by all GMDC companies offering or planning to offer such accounts to their employees. The first step is to distribute this document to HR, the plan administrator and the ceo. Also, all FSA plans differ, so employers are advised to talk to their employees about their specific programs. It should be noted that employees currently enrolled in FSA programs for the calendar year 2003 may be eligible for this benefit. That means OTC expenses previously submitted and denied during this current plan year may be resubmitted for reimbursement. Also, OTC product purchases must be "substantiated," and employees should be encouraged to consult with their plan administrator for clarification on what proof of purchase is needed.

Employees who plan to participate in FSA programs that cover OTCs in 2004 should be encouraged to keep OTCs in mind when deciding on how much money to set aside for the coming year. Also, employees who have chosen not to participate in their employers' FSA programs until now should be prompted to take another look at their companies' particular programs. This new revenue ruling gives employees a practical option for not leaving, and therefore losing, money in their FSAs.

It is recommended that wholesalers, retailers and OTC suppliers with covered products create advertising, merchandising and promotional programs supporting the use of the FSA accounts and purchase of the covered OTCs. Coordination between suppliers, wholesalers and retailers may be a significant help. Retailers and wholesalers should identify employers in their trading areas offering FSAs so that specific programs can be developed. For retailers, customer education can be achieved via pharmacists, brochures, bag stuffers, shelf-talkers, POP, pharmacy counter displays and window banners. A section within the weekly circular devoted to covered items may be appropriate. Retailers can also deploy external outreach initiatives via community programs and ad agencies. Promotions in the final quarter of 2003 should focus on the use-it-or-lose-it restriction.

RESOURCES

For further information, visit the Consumer Healthcare Products Association (CHPA) website www.chpa-info.org, or call CHPA at 202-429-9260. You may also write or email Virginia Cox at CHPA (1150 Connecticut Ave., NW, Washington DC 20036 or Vcox@chpa-info.org). To review the revenue ruling for specific details, visit an IRS website, <http://www.irs.gov/pub/irs-irbs/irb03-38.pdf>.

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