

**DESCRIPTION OF H.R. 5842, THE
“RESTORING ACCESS TO MEDICATION ACT”**

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
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Prepared by the Staff
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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on May 31, 2012, of H.R. 5842, “Restoring Access to Medication Act,” a bill to amend the Internal Revenue Code of 1986 to repeal the provisions which disqualify expenses for over-the-counter medicine under health savings accounts, Archer MSAs, health flexible spending arrangements, and health reimbursement arrangements.¹ This document,² prepared by the staff of the Joint Committee on Taxation, provides a description of these provisions.

¹ Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

² This document may be cited as follows: Joint Committee on Taxation, *Description of H.R.5842, the “Restoring Access to Medication Act”* (JCX-46-12), May 29, 2012. This document can also be found on the internet at www.jct.gov.

A. Repeal of the Disqualification of Expenses for Over-the-Counter Medicine Under Health Savings Accounts, Archer MSAs, Health Flexible Spending Arrangements, and Health Reimbursement Arrangements

Present Law

Individual deduction for medical expenses

Expenses for medical care, not compensated for by insurance or otherwise, are deductible by an individual under the rules relating to itemized deductions to the extent the expenses exceed 7.5 percent (generally 10 percent for years after 2012) of adjusted gross income (“AGI”).³ Medical care generally is defined broadly as amounts paid for diagnoses, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure of the body.⁴

Under an explicit limitation in the Code, any amount paid during a taxable year for medicine or drugs is deductible as a medical expense only if the medicine or drug is a prescribed drug or insulin.⁵ The term prescribed drug means a drug or biological which requires a prescription of a physician for its use by an individual.⁶ Thus, any amount paid for medicine available without a prescription (“over-the-counter medicine”) is not deductible as a medical expense, including any medicine prescribed or recommended by a physician.⁷

Exclusion for employer-provided health care

Employees are not taxed on (that is, may exclude from gross income) the value of employer-provided health coverage under an accident or health plan.⁸ In addition, any reimbursements under an employer-provided accident or health plan for medical care expenses for employees, their spouses, their dependents, and adult children under age 27 generally are excludable from gross income.⁹ An employer may agree to reimburse expenses for medical care of its employees (and their spouses and dependents), not covered by a health insurance plan, through a flexible spending arrangement (“FSA”) which allows reimbursement not in excess of a specified dollar amount. The amounts available for reimbursement must be exclusively for

³ Sec. 213(a). The 7.5 percent of AGI threshold increases to 10 percent for taxable years beginning after December 31, 2012. However, this increase in the percentage does not apply until taxable years beginning after December 31, 2016 with respect to any taxpayer if the taxpayer or the taxpayer’s spouse has attained age 65 before the close of the taxable year.

⁴ Sec. 213(d). There are certain limitations on the general definition including a rule that cosmetic surgery or similar procedures are generally not medical care.

⁵ Sec. 213(b).

⁶ Sec. 213(d)(3).

⁷ Rev. Rul. 2003-58, 2003-1 CB 959.

⁸ Sec 106.

⁹ Sec. 105(b).

reimbursement for medical care because the exclusion does not apply to amounts which the employee would be entitled to irrespective of whether he or she incurs expenses for medical care.¹⁰

Such dollar amount is either elected by an employee under a cafeteria plan (“Health FSA”) or otherwise specified by the employer under a health reimbursement arrangement (“HRA”). Reimbursements under these arrangements are also excludable from gross income as reimbursements for medical care under employer-provided health coverage.

Health savings accounts

An individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) may establish a health savings account (“HSA”). In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. Thus, earnings on amounts in HSAs are not taxable.

Subject to limits,¹¹ contributions made to an HSA by an employer, including contributions made through a cafeteria plan through salary reduction, are excludable from income (and from wages for payroll tax purposes). Contributions made by individuals are deductible for income tax purposes, regardless of whether the individuals itemize. Distributions from an HSA that are used for qualified medical expenses are excludable from gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65). Similar rules apply for another type of medical savings arrangement called an Archer medical savings account (“Archer MSA”).¹²

Medical care for excludable reimbursements

For purposes of the exclusion for reimbursements under employer-provided accident and health plans (including under Health FSAs and HRAs), and for distributions from HSAs and Archer MSAs used for qualified medical expenses, the definition of medical care is generally the same as the definition that applies for the itemized deduction for the cost of medical care. However, prior to the enactment of the Patient Protection and Affordable Care Act (referred to as

¹⁰ Treas. Reg. sec. 1.105-2.

¹¹ For 2012, the maximum aggregate annual contribution that can be made to an HSA is \$3,100 in the case of self-only coverage and \$6,250 in the case of family coverage. The annual contribution limits are increased by \$1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as “catch-up contributions). Contributions, including catch-up contributions, cannot be made once an individual is enrolled in Medicare.

¹² Sec. 220.

the “Affordable Care Act”),¹³ the limitation (applicable to the itemized deduction) that only prescription medicines or drugs and insulin are taken into account did not apply. Thus, for example, amounts paid from a Health FSA or HRA, or funds distributed from an HSA to reimburse a taxpayer for nonprescription drugs, such as nonprescription aspirin, allergy medicine, antacids, or pain relievers, were excludable from income even though, if the taxpayer paid for such amounts directly (without such reimbursement), the expenses could not be taken into account in determining the itemized deduction for medical expenses.¹⁴

For years beginning after December 31, 2010, the Affordable Care Act changed the definition of medical care for purposes of the exclusion for reimbursements for medical care under employer-provided accident and health plans and for distributions from HSAs and Archer MSAs used for qualified medical expenses to require that over-the-counter medicine (other than insulin) be prescribed by a physician in order for the medicine to be medical care for these purposes.¹⁵ Thus, under present law, a Health FSA or an HRA is only permitted to reimburse an employee for the cost of over-the-counter medicine if the medicine is prescribed by a physician and distributions from an HSA or an Archer MSA used to purchase over-the-counter medicine is not a qualified medical expense unless the medicine is prescribed by a physician.

Description of Proposal

The proposal repeals the change to the definition of medical care made by the Affordable Care Act for purposes of the exclusion for reimbursements for medical care under employer-provided accident and health plans and for distributions from HSAs or Archer MSAs used for qualified medical expenses that requires that over-the-counter medicine (other than insulin) be prescribed by a physician in order for the medicine to be medical care for these purposes. Thus, for example, amounts paid from a Health FSA or HRA, or funds distributed from an HSA or an Archer MSA to reimburse a taxpayer for nonprescription drugs, such as nonprescription aspirin, allergy medicine, antacids, or pain relievers, are excludable from income even though, if the taxpayer paid for such amounts directly (without such reimbursement), the expenses could not be taken into account in determining the itemized deduction for medical expenses.

Effective Date

The proposal is effective with respect to expenses incurred after December 31, 2012.

¹³ Pub. L. No 111-148. Various provisions of the Affordable Care Act are amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152.

¹⁴ Rev. Rul. 2003-102, 2993-2 C.B. 559, now obsolete by Rev. Rul. 2010-23, 2010-39 I.R.B. 388.

¹⁵ Sec. 9003 of the Affordable Care Act. Notice 2010-59, 2010-39 I.R.B. 388, provides guidance on this change to the definition of medical care for these purposes.

B. Revenue Effect of the Proposal

The following presents the estimated Federal fiscal year budget effects of the proposal.

	Fiscal Years [Millions of Dollars]											
<u>Item</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2013-17</u>	<u>2013-22</u>
Repeal the limitation on reimbursement of over-the-counter medications from health FSAs, HRAs, HSAs, and Archer MSAs [1]....	-223	-305	-332	-361	-390	-419	-448	-479	-571	-544	-1,611	-4,012

NOTE: Details do not add to totals due to rounding.

[1] Estimate includes the following off-budget effects:

<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2013-17</u>	<u>2013-22</u>
-54	-73	-80	-87	-94	-100	-108	-115	-123	-130	-387	-963