

POLICY FOCUS

Modernizing Flexible Spending Accounts

RECIPES FOR RATIONAL GOVERNMENT FROM INDEPENDENT WOMEN'S FORUM

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WHAT YOU NEED TO KNOW

As the number of single heads of household and two working parent families grows, more Americans are struggling to balance work and family responsibilities. Many want government to do more to help people. Often, lawmakers debate proposals to mandate paid leave benefits or create new government programs to fund time off. These debates are worth having, but there's another route to ease burdens on working families: encouraging and rewarding saving.

Flexible Spending Accounts (FSAs) are one vehicle that policymakers should consider modernizing to better support workers. Currently, these tax-advantaged savings accounts are available in a majority of large companies. However, only a small share of workers use them because of the restrictions on allowable uses of the funds and the requirement that funds must be used each year, or risk being forfeited.

Expanding FSAs so that workers can save more and use funds to cover more critical expenses—including to make up for income lost during unpaid leave from work—and eliminating the “use-it-or-lose-it” provision would increase participation and make these accounts a vital tool for workers. By making it easier for workers to prepare for critical expenses, FSAs would reduce reliance on safety net programs and increase financial security for Americans.

Mandating that employers provide paid leave benefits and creating a paid leave entitlement program have significant drawbacks, such as raising employment costs and discouraging hiring. In contrast, expanded FSAs make time off more affordable, while preserving flexibility and encouraging work and saving, without these unfortunate unintended consequences.

Policymakers should prioritize modernizing Flexible Spending Accounts.

WHY YOU SHOULD CARE

Policymakers are debating many policy initiatives purported to help workers balance family and work responsibilities, and specifically to help workers who need time off from work. Unfortunately, many proposals have significant drawbacks:

- **Employment Mandates:** Requiring all employers to provide paid time off makes hiring and retaining workers more expensive. This will particularly impact lower-income workers, and women of childbearing age. Especially with increased automation, companies will look for ways to reduce jobs if employment costs rise.
- **Government Entitlement Programs:** Taxing workers so that government can directly pay employees for qualifying absences from work also has drawbacks. A one-size-fits-all leave program would discourage alternative work arrangements (such as telecommuting and working from home) and penalize some employees while favoring others, creating unfairness and resentment.

In contrast, facilitating savings for critical expenses—including time off from work—would not impose these costs or limit opportunities for workers. It would encourage the responsible use of funds, since unused assets will be preserved for future needs. It would also help the growing number of workers who do not have a traditional employment relationship, but are self-employed, independent contractors, or work for multiple employers.

MORE INFORMATION

How FSAs Work Today

Under current law, employers can offer their employees **Flexible Spending Accounts**, which employees may choose to fund by reducing their salary and having the employer contribute those funds to the FSA. Employees can use money in FSAs for dependent care, adoption costs, transportation assistance, and certain uncovered medical expenses. However, employees must contribute to separate accounts for different classes of expenses.

The money contributed to a FSA is not subject to either income or employment taxes. However, the current law stipulates that at the end of the year, funds that remain in FSAs and have not been spent are forfeited to the employer. Under **current rules**, employers now have the option of giving employees an additional 2.5 months to use up their funds and carryover a modest amount (\$500) of unspent funds.

FSA contributions are **capped** and revised each year. For example, in 2017, the cap for dependent care FSAs was \$5,000 (for married taxpayers), while the cap for health FSAs was \$2,600.

FSAs' Limitations

The Congressional Research Service found that, as of 2010, 39 percent of all workers had access to a healthcare flexible spending account. In

larger businesses (those with more than 100 workers) 56 percent had access to a healthcare FSA, compared to just 20 percent of workers in companies with fewer than 100 workers.

However, only a small share of employees—an estimated 37 percent as of 2009—who were offered participation in a healthcare FSA used one. The average contribution that year was less than \$1,500. There are clear reasons why the participation rate for FSAs is low:

- **FSAs Are Confusing:** Employees have to determine what expenses are eligible for reimbursement and then predict at the beginning of the year how much they anticipate spending in each category. This is hard for employees to calculate, especially if they do not face regular expenses, and requires them to revisit their savings plans (and fill out new paperwork) each year.
- **Low Caps Limit the Upside:** Tight caps on how much people can contribute to an FSA each year—and therefore on their tax savings—also discourage people from taking on the hassle of opening an FSA and withholding money from their paychecks.
- **Risk of Losing Savings:** Employees also fear overestimating how much they will spend in a given year and forfeiting their savings. The specter of lost savings, in addition to the administrative hassle of opening an account, is a big barrier to participation.

Given these significant problems, it's no wonder that the participation rate is low.

Reforming FSAs to Help More Workers

Currently FSAs are just a way for some taxpayers with predictable expenses to reduce their costs by being able to use pre-tax dollars to pay those expenses.

However, by reforming FSAs, policymakers could greatly increase their effectiveness so that FSAs help improve workers' overall financial security by allowing them to prepare for unexpected expenses as well as to reduce the financial burden of meeting other critical needs.

Here are a few reforms lawmakers should consider:

Consolidating FSAs

Rather than requiring workers to save in different FSA vehicles for different categories of expenses, Congress should consolidate FSAs to encourage more workers to open an FSA account, knowing that they will be able to use these funds for a variety of important potential expenses.

Expanding the Uses of FSA Funds

Policymakers should change the current restrictions stipulating how FSAs funds can be used so that workers can also pay for additional expenses. Most importantly, workers should be able to save and use funds to replace income lost during unpaid absences from work for

reasons that are covered by the Family and Medical Leave Act, such as the birth or adoption of a baby, a personal illness, or the illness of a family member. This could be critical in helping workers who currently lack paid leave benefits, including self-employed workers and independent contractors who work for a variety of employers but lack traditional employee benefits, afford to take time off they need.

Increasing How Much Workers Can Save

Policymakers should increase the cap of how much workers can save in a year to encourage greater participation and help more workers accumulate a nest egg that will be available for critical expenses. Rather than setting an annual cap, policymakers should consider capping total assets that can be held in an FSA account so the workers are encouraged to set aside the equivalent of a rainy-day fund, and then replenish that fund whenever it has been depleted.

Changing the Use-It-Or-Lose-It Provision

The most important reform to encourage people to use FSAs to increase overall financial security is to eliminate the use-it-or-lose-it provision so that people are encouraged to save more and to reserve these funds for critical needs, rather than to face the pressure that they must spend down their savings each year.

These reforms would transform the limited FSA program into one that enhances financial security for millions of American workers.

Answering Concerns about FSA Expansion

Critics of expanding FSAs or other tax advantaged savings vehicles typically express the following concerns:

Criticism: Savings Vehicles Won't Help the Poor

The most common criticism of savings vehicles is that they fail to help those with low incomes who do not have enough disposable income to participate, and whose tax rates are so long that they do not benefit from the tax-advantage.

This is a legitimate concern and limitation. However, savings vehicles are still important in helping middle-income workers who also struggle today to make ends meet, and particularly who too often have little or **nothing saved** for a rainy day.

However, policymakers could consider ways to help those with lower incomes. First, employers could be allowed and encouraged to contribute to FSAs. Charities could be allowed to contribute to the FSAs held by those with lower incomes. Policymakers could also consider matching savings for those with low incomes to encourage participation and augment savings.

Criticism: The Rich Use This as a Tax Shelter

Similarly critics point out that those with higher incomes, who already enjoy the highest levels of financial security, are able to take advantage of these savings vehicles, decreasing their

taxable income and ultimately paying less to government. However, policymakers can limit this problem by capping the overall assets allowed in FSAs so that they truly serve as rainy day funds, rather than as a tax shelter, and by phasing out eligibility for FSA contributions for those with higher incomes.

Criticism: Tax-Advantaged Savings Vehicles Mean Less Tax Dollars for Government

Allowing people to put away pre-tax income reduces payments to the U.S. Treasury. However, a well-designed FSA could have the benefit of making people less dependent on other forms of government assistance by increasing their overall financial security and encouraging them to save for critical needs. Given the potentially important role these accounts could have in increasing financial security for Americans, policymakers can find other savings in the federal budget to offset any loss in tax revenue.

Benefit Policies in the Gig Economy

Our workforce is changing rapidly, and our labor laws need to adapt to new realities. Younger workers increasingly value flexible working arrangements and a decreasing share of workers now fit into the traditional mold of working at one specific location, for one specific employer, for normal business hours from 9 am to 5 pm.

In 2015, **Gallup** reported that nearly one in ten workers telecommuted more than half of work days. While the exact size of the gig workforce varies and is difficult to define, the **Chairman of Intuit** recently estimated that more than one-third of workers are independent contractors or self-employed –and that that share will continue to grow in the future. A growing number of job classes, many that are held by lower income earners, but many that also have been a staple for the middle-class, are being replaced with automation.

These trends should caution policymakers against relying on traditional employer-employee relationships, with employers expected to serve as the primary vehicle for providing important benefits for their employees. This approach would help a shrinking share of workers, and by increasing employment costs, could put vulnerable people out of work entirely. A better approach empowers individual workers to save on their own.

WHAT YOU CAN DO

- **Get Informed:** Learn more about Flexible Spending Accounts. Visit:
 - **Independent Women's Forum**
 - **Working for Women Report**
 - **Society for Human Resource Management**
- **Talk to Your Friends:** Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.
- **Become a Leader in the Community:** Get a group together each month to talk about

a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

- **Remain Engaged Politically:** Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

ABOUT INDEPENDENT WOMEN'S FORUM

Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

We rely on the support of people like you! Please visit us on our website www.iwf.org to get more information and consider making a donation to IWF.

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