



A Simple and Modest Change in Tax Regulations for Flexible Spending Accounts Will Benefit Employees and Support Patient-Driven Health Care

I. *Issue:* Current tax laws for flexible spending accounts (FSAs) significantly limit their usefulness to employees and their families.

- Regulations keep people from exercising greater control and responsibility over their own health care spending decisions.
- Currently, employees must “use or lose” employee-funded flexible spending account (FSA) balances during the current calendar year under Section 125 of the Internal Revenue Code.
- Through these accounts, employees may set aside part of their income to pay for qualified medical expenses on a pre-tax basis.
- Through these accounts, employers make funds available for employees and their families to spend on routine health care and preventive health care.

II. *Viewpoint:* Minor tax changes and clarifications for FSAs would make these health benefits more valuable to employees and their families.

Changes would promote greater individual control over and responsibility for health care spending decisions.

Given current economic conditions, job losses, and turnover, allowing employees to keep their own money to cover health expenses makes sense.

The Business Group, representing over 230 large employers who provide coverage for 50 million Americans, encourages these simple changes and clarifications of the tax law to encourage and promote the usefulness and value of FSAs.

Preserving favorable tax treatment for individuals as they carry forward unused balances would benefit individuals and help engage the consumer in the financing of the system. Experts agree that the fact that consumers have little financial stake in health care decisions helps fuel the rise in health care costs.

Recommendation:

The Business Group Recommends that Congress Permit the Carry Forward of Employee Flexible Spending Accounts:

- **Amend Section 125 of the tax code to repeal the “use-it-or-lose-it” rule for Section 125 FSAs without negative tax consequences for individuals. Employees should be able to carry over amounts into subsequent years and into retirement without penalty.**

III. Rationale:

Because of FSA “Use-It-or-Lose-It” Rule, Employees Undervalue, Underuse FSAs

- The penalty keeps many employees from more extensive use of FSAs for unreimbursed health care expenses. Currently only about 15-20% of employees use FSAs, and the average amount allocated per year is between \$700 and \$800.
 - Employees lose their own money at the end of each year if they do not use it.
 - Many people waste health care dollars at the end of the year to avoid losing their money.
 - Health expenses are often uneven and employees give up trying to estimate them.
 - Employees often underfund for their true needs to avoid forfeiture.
 - The arbitrary time limit prohibits employees from pre-funding future years’ health care expenses.

Repealing “Use-It-or-Lose-It” Rule Would Help People Pay for Health Care

- People could use accumulated unspent money for health care expenses in later years.
- Employees would no longer have to spend money on unnecessary health care at the end of the year to avoid losing their money.
- Employees could put away larger amounts to fund their anticipated health care needs without fear of losing anything. Medical expenses are often unpredictable, and employees may need more in some years than in others.