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## Modifications to Flexible Spending Accounts “Use It or Lose It” Rules Rejected by the US Department of the Treasury

US Senate Finance Committee Chair Charles E. Greeley and others were unsuccessful in their efforts to get the Department of the Treasury to modify Flexible Spending Accounts (FSAs) rules. They want to allow participants to be able to roll over balances of \$500 or less to the next year. FSAs allow employees to use pre-tax dollars for medical expenses not covered by insurance. With these accounts, employees must predict their medical expenses, which are generally deducted in equal amounts from their paychecks, before taxes are deducted, which lowers the taxable amount. Any unused funds at the end of the calendar year are forfeited.

Although legislation to modify the rules passed in the 108 th Congress last year, it went nowhere with the Senate. Greeley sent a letter to the US Secretary of the Treasury, John Snow, asking that he move this effort forward. Snow said, in a letter dated December 23, 2004, that “the ‘use it or lose it’ rule was imposed in order to fulfill the Congressional mandate that cafeteria plans not provide for the deferral of compensation.” Snow went on to say that “absent Congressional action” the Treasury did not have the authority to make the modification. In addition, the modification would have a potentially negative “impact on important health care priorities of the Congress and this Administration.” One impact might be lost tax revenue, should more employees who are hesitant about losing money find assurance in the modification and participate in FSAs.<sup>1</sup> Another might be competition for health savings accounts, authorized by Congress in 2003.

The average person puts approximately \$1,200 in an FSA account. The list of reimbursable items differs from plan to plan. At the end of the year, some feel pressured to spend on miscellaneous or unneeded items to use all of the money in the account. This is one reason why the majority, up to 70 percent, of those employees who are eligible do not contribute to FSAs.

### More about Flexible Spending Accounts from the US Department of Labor, Bureau of Labor Statistics

Health care flexible spending accounts are employer-established benefit plans that reimburse employees for specified medical expenses as they are incurred. These accounts are allowed under section 125 of the Internal Revenue Code and are also referred to as “cafeteria plans” or “125 plans.” The employee contributes funds to the account through a salary reduction agreement and is able to withdraw the funds set aside to pay for medical bills. The salary reduction agreement means that any funds set aside in a flexible spending account escape both income tax and Social Security tax. Employers may contribute to these accounts as well.

There is no statutory limit on the amount of money that can be contributed to health care flexible spending accounts. However, some companies place a limit of \$2,000 to \$3,000 on flexible spending accounts. Once the amount of contribution has been designated during the open enrollment period that occurs once each year, the employee is not allowed to change the amount or drop out of the plan during the year unless he or she experiences a change of family status. By law, the employee forfeits any unspent funds in the account at the end of the year. There have been proposals introduced in Congress to ease this “use it or lose it” rule by allowing up to \$500 to be carried over to the next year; such proposals have not been enacted.

### More about Health Savings Accounts from the US Department of Treasury

A Health Savings Account is an alternative to traditional health insurance; it is a savings product that offers a different way for consumers to pay for their health care. HSAs enable you to pay for current health expenses and save for future qualified medical and retiree health expenses on a tax-free basis.

You must be covered by a High Deductible Health Plan (HDHP) to be able to take advantage of HSAs. An HDHP generally costs less than what traditional health care coverage costs, so the money that you save on insurance can therefore be put into the Health Savings Account.

You own and you control the money in your HSA. Decisions on how to spend the money are made by you without relying on a third party or a health insurer. You will also decide what types of investments to make with the money in the account in order to make it grow.

You must have an HDHP if you want to open an HSA. Sometimes referred to as a “catastrophic” health insurance plan, an HDHP is an inexpensive health insurance plan that generally doesn’t pay for the first several thousand dollars of health care expenses (for example, your “deductible”) but will generally cover you after that. Of course, your HSA is available to help you pay for the expenses your plan does not cover.

In order to qualify to open an HSA, your HDHP minimum deductible must be at least \$1,000 (self-only coverage) or \$2,000 (family coverage). The annual out-of-pocket (including deductibles and co-pays) cannot exceed \$5,100 (self-only coverage) or \$10,200 (family coverage). HDHPs can have first dollar coverage (no deductible) for preventive care and apply higher out-of-pocket limits (and copays & coinsurance) for non-network services.

## Reference

1. Stephen Taub, “FSAs: No More ‘Use It or Lose It’?” CFO.com, January 6, 2005.

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