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Your Money

The Fight Over Flexible Spending Accounts

By RON LIEBER

The tumult at the town hall meetings has mostly died down and the debates over socialized medicine have gotten a bit old for everyone. But the fate of a benefit that puts hundreds of millions of dollars in Americans' pockets each year remained unresolved this week, with senators pitching in with suggestions to keep as much money as possible in the hands of their constituents.

Who would have thought that so many people would go to the mat over the lowly flexible spending account?

Flexible spending accounts allow people to take money out of their paychecks before paying taxes on it and to set it aside to use for health care expenses that insurance doesn't cover. There is no legal limit on how much you can set aside each year, though employers generally set a cap around $4,000 or $5,000.

Senator Max Baucus, Democrat of Montana and author of the Senate health care bill, would like to place a much lower $2,500 annual limit on what people can save, among other restrictions. The House-Senate Joint Committee on Taxation figures this will allow the government to take in $14.6 billion from 2011 and 2019. So far so good right? We have to pay for the health care bill somehow.

The problem, however, is that to people who put more than $2,500 away each year, this looks an awful lot like a tax increase. After all, if they can't put as much money aside, they'll pay more in income and payroll taxes. And President Obama, when he was running for office, promised that no family earning under $250,000 would see higher taxes.

Now, a not-quite grass-roots effort has sprung up, led by companies that administer flexible spending accounts and others. At savemyflexplan.org, the group encourages individuals to write their representatives in Washington and sound off.

The question, however, is whether this is something worth fighting for.

Flexible spending accounts are great in theory. They can cover co-pays and deductibles, birth control and abortion, Lasik and glasses. Orthodontists love them, since braces are eligible, too.

In practice, however, the accounts are a hassle. You take money out of your paycheck once to finance the account. Then you reach into your wallet for the health care expenses themselves, effectively fronting the money for a second time. Finally, you gather all your receipts and send them in for reimbursement. While there are now debit cards that allow you to pay for expenses directly from the spending account, not every practitioner accepts them. And the card companies often demand receipts anyway to prove you bought aspirin and not candy at the drugstore.

This isn't the real reason the accounts are in senators' sights, though. One factor is this: If you don't use the money in your account within a year (or during the two-and-a-half-month extension that the government also allows), you lose it and your company keeps it. This inevitably leads to the annual goofball ritual of people running around town buying glasses or loading up on contact lens solution before the deadline.

And that's if you're lucky. Uwe E. Reinhardt, an economics professor at Princeton who is not a fan of the accounts, wrote a post earlier this year on the Economix blog at NYTimes.com noting that his wife once scheduled year-end, his-and-her colonoscopies to spend their funds.

Drugstore.com even has a flexible spending account mini-store on its site, so that no one should be confused about what they can spend their money on. All of these spending sprees with leftover funds may well encourage more health care spending than is necessary.

Detractors also complain that wealthy people benefit the most from the accounts. After all, the more you earn, the higher your income tax rates. And the higher your income tax rates, the more you stand to save by putting pretax money in the accounts. And people who earn more usually have an easier time setting aside money in the first place.

John Hickman, an Atlanta lawyer who heads the employee benefits practice for Alston & Bird, is quick to point out that employers have to satisfy federal tests to make sure that the benefits of a flexible spending account plan are not going only to the fat cats. One existing rule keeps a company's owners and officers from deriving more than a quarter of the plan's benefits, while another new rule makes sure that the highly paid in general don't benefit disproportionately.

Meanwhile, Jody Dietel, the chief compliance officer at WageWorks, which helps companies administer about 1.5 million accounts, notes that the average salary of its participants is about $55,000. She also says there are about 35 million people covered under health care flexible spending accounts. They can't all be rich, right?

Even if they aren't wealthy, however, the people who have these plans are certainly privileged.

First of all, they have to be employed (and not self-employed, since soloists aren't eligible unless a spouse has access to a plan and can cover the whole family). Then, they have to work for an employer willing to set up the accounts and deal with their continuing management. Most employers willing to do this probably already offer decent health insurance.

So you can start to see why a $2,500 limit on these accounts looks like a ripe target for legislators hoping to pay for health insurance for people who have none. "Today, only a minority of workers have access to these accounts, and most of those contributions are already well below this limit," Erin Shields, press secretary for the Senate Committee on Finance, said in an e-mail message.

The problem with this line of reasoning, however, is that there are plenty of middle-class people who do put aside more than $2,500 to pay for diabetes or asthma medication or treatment for other chronic conditions. Large families also often set aside much more than the proposed limit. They will lose out if the $2,500 cap stays in place, especially if it doesn't rise with inflation.

This part of the health care bill would be a lot more palatable if it achieved its savings by capping the household income of people who can participate. So if your household income is under, say, $100,000 on the 2009 tax return that you file in 2010, you could participate in a plan in 2011.

But that option isn't on the table, and it isn't clear why. One possible explanation is that the $100,000 figure could provide even more political ammunition for anyone trying to claim that those who earn between $100,000 and $250,000 would then be facing a tax increase — and that President Obama broke his promise.

It's probably too late for a more sensible solution to emerge, but one can always hope. In the meantime, be aware that the days of setting aside $4,000 each year to pay for designer prescription sunglasses and therapeutic massages are probably numbered.

Use that tax break before you lose it, because many of you probably don't deserve to have it in the first place.

Tara Siegel Bernard contributed reporting.