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Employee Benefit
Research Institute

EBRI Databook on Employee Benefits
Chapter48:
Flexible Benefit Plans

UPDATED JULY 2011

Data for the following tables are from the National Compensation Survey:

- Table 48.1 Flexible Benefit Plans
- Table 48.3 Expenses Covered by Reimbursement Accounts

The data in this survey are presented as a percentage of full-time employees participating in a health plan with the particular cost-management strategy. This data-set is maintained by the U.S. Department of Labor, Bureau of Labor Statistics (BLS). The data are available on the BLS Web page at http://www.bls.gov/ncs/ebs/. Preliminary data are released in a news release format. The most recent news releases are in the section titled "ECONOMIC NEWS RELEASES." More detailed tabulations are available at the above Web page under the section titled "PUBLICATIONS AND OTHER DOCUMENATION."

Before 1999, data from the Employee Benefit Survey were released in three separate publications covering medium and large private establishments (establishments with 100 or more employees), small private establishments (establishments with 99 or fewer employees), and state and local governments. Starting with the 1999 data, BLS began publishing data for all private industry. The section titled "PUBLICATIONS AND OTHER DOCUMENTATION" provides supplementary data for 1999 and 2000 under the old format of medium and large private establishments and small private establishments.

EBRI maintains the following tables and charts:

Table 48.7 -- UPDATED JULY 2011

Employee Tax Savings from Health Care Flexible Spending Accounts (FSAs)

Employee Tax Savings Realized from a Health Care FSA[a], 2010 Tax Year

	Employee Savings	
	With FSA	Without FSA[b]
Payroll Tax Effects		
Earnings	$35,000	$35,000
Less:		
FSA contribution	$1,426[c]	$0
Equals FICA taxable income	$33,574	$35,000
FICA tax (7.65%)	$2,568	$2,678
Income Tax Effects		
Gross income	$35,000	$35,000
Less:		
FSA contribution	$1,426	$0
standard deduction[d] and personal exemption	$9,350	$9,350
Equals taxable income	$24,224	$25,650

federal income tax[d]	$3,215	$3,425
Disposable Income		
Gross income	$35,000	$35,000
Less:		
FICA	$2,568	$2,678
federal income tax	$3,215	$3,425
medical expenses	$1,426	$1,426
Equals net disposable income	$27,791	$27,471
Net Savings[e]	$320	

Source: EBRI estimates.

[a]This example is based on an employee whose only income is wage earnings and who takes the standard deduction and one federal exemption, pays no state income taxes, and uses all eligible funds in his or her FSA.

[b]The employee without the health care FSA cannot deduct his or her health care expenditures because they do not exceed 7.5 percent of gross income.

[c]Average contribution to health care FSAs in 2010 for all employers. See Mercer Human Resource Consulting. *National Survey of Employer-Sponsored Health Plans, 2010* (New York, NY: William M. Mercer, Inc., 2010).

[d]Standard deduction and federal income tax is based on an individual claiming single under and 65.

[e]Net employee savings with an FSA will be higher if the salary reduction is higher or the individual is in a higher tax bracket.

Table 48.8 -- UPDATED JULY 2011

Employee Tax Savings from Dependent Care Flexible Spending Accounts (FSAs)

Employee Tax Savings Realized from a Dependent Care FSA[a], 2010 Tax Year

	Employee Savings	
	With FSA	Without FSA[b]
Payroll Tax Effects		
Earnings	$35,000	$35,000
Less:		
FSA contribution	$3,048[c]	$0
Equals FICA taxable income	$31,968	$35,000
FICA tax (7.65%)	$2,444	$2,678
Income Tax Effects		
Gross income	$35,000	$35,000
Less:		
FSA contribution	$3,048	$0
standard deduction[d], one dependent, and personal exemption	$13,000	$13,000
Equals taxable income	$18,968	$22,000
federal income tax[d]	$2,428	$2,885
Disposable Income		
Gross income	$35,000	$35,000
Less:		
FICA	$2,444	$2,678
federal income tax	$2,428	$2,885
dependent care expenses	$3,048	$3,048
Equals net disposable income	$27,080	$26,389
Net Savings[e]	$691	

Source: EBRI estimates.

[a]This example is based on an employee whose only income is wage earnings and who takes the standard deduction and one federal exemption, pays no state income taxes, and uses all eligible funds in his or her FSA.

[b]The employee without the dependent care FSA cannot deduct his or her dependent care expenditures because they do not exceed 7.5 percent of gross income.

[c]Average contribution to dependent care FSAs in 2008 for all employers. See Mercer Human Resource Consulting. *National Survey of Employer-Sponsored Health Plans, 2008* (New York, NY: William M. Mercer, Inc., 2009).

[d]Standard deduction and federal income tax is based on an individual claiming single under, 65 with one dependent child.

[e]Net employee savings with an FSA will be higher if the salary reduction is higher or the individual is in a higher tax bracket.

Table 48.9 -- UPDATED JULY 2011

Employer Tax Savings from Health Care Flexible Spending Accounts (FSAs)

Employer Tax Savings Realized from a Health Care FSA[a], 2010 Tax Year

	Employer Savings	
	With FSA	Without FSA
Annual Payroll Expenses	$3,000,000	$3,000,000
Less		
Employee health care FSA contribution	51,156	0
Taxable Payroll Expenses	2,948,844	3,000,000
FICA tax (7.65%)	225,587	229,500
Total Payroll Expenses (Annual Payroll Expenses plus FICA tax)	3,225,587	3,229,500
Net Employer Savings[b]	$3,913	

Source: EBRI estimates.

[a]Example is based on a firm that employs 100 workers with an average salary of $30,000 and assumes that 36 percent of employees contribute an average of $1,426. Data for the assumptions is derived from Mercer Human Resource Consulting. *National Survey of Employer-Sponsored Health Plans, 2010* (New York, NY: William M. Mercer, Inc., 2011), and is based on data representing small employers defined as employers with 10 to 499 employees. This example does not adjust for administrative costs. For a discussion of administrative costs in FSAs, see Hewitt Associates, *Flexible Compensation Programs and Practices: 1993* (Lincolnshire, IL: Hewitt Associates, 1993).

[b]Employer savings will be higher if more employees contribute a greater amount on average to the FSA.

Table 48.10 -- UPDATED JULY 2011

Employer Tax Savings from Dependent Care Flexible Spending Accounts (FSAs)

Employer Tax Savings Realized from a Dependent Care FSA[a], 2010 Tax Year

	Employer Savings	
	With FSA	Without FSA
Annual Payroll Expenses	$3,000,000	$3,000,000
Less		
Employee dependent care FSA contribution	36,540	0
Taxable Payroll Expenses	2,963,460	3,000,000
FICA tax (7.65%)	226,705	229,500
Total Payroll Expenses (Annual Payroll Expenses plus FICA tax)	3,226,705	3,229,500
Net Employer Savings[b]	$2,795	

Source: EBRI estimates.

[a]Example is based on a firm that employs 100 workers with an average salary of $30,000 and assumes that 12 percent of employees contribute an average of $3,045. Data for the assumptions is derived from Mercer Human Resource Consulting. *National Survey of Employer-Sponsored Health Plans, 2008* (New York, NY: William M. Mercer, Inc., 2011), and is based on data representing small employers defined as employers with 10 to 499 employees. This example does not adjust for administrative costs. For a discussion of administrative costs in FSAs, see Hewitt Associates, *Flexible Compensation Programs and Practices: 1993* (Lincolnshire, IL: Hewitt Associates, 1993).

[b]Employer savings will be higher if more employees contribute a greater amount on average to the FSA.

Chart 48.1 -- UPDATED MARCH 2007

Flexible Benefits Plans, Legislation, and Regulations

Impact of Legislation and Regulations on Flexible Benefits Plans

Legislative or Regulatory Action	Important Provisions
Revenue Act of 1978	• Created sec. 125 and sec. 401(k) of the Internal Revenue Code (IRC). • Sec. 125 allows employees to choose between taxable and nontaxable benefits (which do not defer the receipt of compensation) without taxing the cash if it is not chosen. • Sec. 401(k) allows employees to make pre-tax contributions to a profit-sharing or savings plan. Under the Revenue Act of 1978, employees may choose between cash and deferred contributions to a profit-sharing or savings plan without being taxed if the cash is not chosen.
Miscellaneous Revenue Act	• Permitted sec. 125 plans to include 401(k) plans as a qualified benefit (only 1980 exception to the deferred compensation restriction).
Information release 84-22 (1984)	• Prohibited the use of salary reduction after incurring an expense.
Proposed sec. 125 flexible regulations (1984)	• Defined terms, indicated which benefits may be included in a plan, specified spending account (FSA) rules, and addressed tax issues, nondiscrimination rules, and effective dates. • Imposed three major restrictions on the design of flexible benefit plans: (1) Neither a cafeteria plan nor an FSA may allow more frequent than annual elections of the sources or uses of funds (unless changes are related to a change in family status); (2) FSA funds may be used only for health care, dependent care, or personal legal expenses; (3) FSA funds must be used for expenses incurred during the plan year; all unused funds are forfeited ("use-it-or-lose-it" rule).
Deficit Reduction Act of 1984	• Confirmed sec. 125 proposed regulations and established reporting requirements for sec. 125 plans.
Tax Reform Act of 1986	• Confirmed the permissibility of FSAs and individual salary reduction under sec. 125. Reaffirmed the exemption of sec. 125 deferrals from FICA taxation. • Created sec. 89 of the IRC, which contained complex nondiscrimination rules for all welfare plans (including cafeteria plans).
Proposed sec. 125 regulations (1989) (effective for plan years beginning after December 31, 1988)	• Regulations clarified the kinds of benefits that can be included in a plan, the circumstances under which participants may change or revoke elections, and the requirement that health FSAs must exhibit insurance characteristics. • Benefits were divided into several categories: (1) qualified benefits (do not defer the receipt of compensation and are not includable in an employee's gross income); (2) currently taxable benefits treated as cash; (3) qualified cash or deferred arrangements (pre- and post-tax contributions to 401(k) plans); and (4) nonqualified benefits. • Participants may now change or revoke elections under the following circumstances: (1) significant cost changes of an independent third party health plan; (2) family status changes; (3) separation from service; and (4) cessation of required contributions. Elective contributions to 401(k) plans may be changed at any time. • FSAs must function as accident or health plans so that: (1) the maximum amount of reimbursement under a health FSA must be available at all times during the period of coverage; (2) the period of coverage must be generally 12 months; (3) a health FSA may only reimburse medical expenses covered under sec. 213 of the IRC; (4)

medical expenses must be substantiated by a receipt from a third party; (5) medical expenses must be incurred during the period of coverage; (6) the excess of premiums paid and income of an FSA over claims reimbursements may be used to reduce premiums for the following year or returned to participants as long as funds are allocated on a reasonable and uniform basis (not based on claims experience); (7) analogous rules apply to dependent care spending accounts except for uniform coverage (see (1) above).

Repeal of sec. 89 (1989)

- Pre-sec. 89 nondiscrimination testing was reinstated for all welfare plans.

ERISA Technical Release 91-01 (1991)

- Pending further action, cafeteria plans do not have to attach an auditor's opinion to Form 5500.
- Cafeteria plans do not have to hold employee contributions in trust.

Labor Department Technical Release 92-01 (1992)

- Department of Labor will take no enforcement action against a cafeteria plan that does not comply with ERISA audit and trust requirements, through December 31, 1993.
- Other contributory welfare plans are also temporarily relieved from compliance with ERISA trust requirements with respect to employee contributions used to pay insurance premiums.
- This will remain in effect until final regulations are adopted.

Health Insurance Portability and Accountability Act of 1996

- Created a "pilot program" to test medical savings accounts (MSAs).
- Imposed restrictions on the use of pre-existing condition exclusions.

IRS Rules on Changes in Status and HIPAA (1997)

- Clarified the rules under which flex plan participants may be allowed to change their elections because of a change of status, such as childbirth or divorce.
- Exempted health FSAs from HIPAA's portability and certification rules.

IRS Rules on Health FSAs and COBRA (1999)

- Exempted health FSAs from COBRA continuation rules if certain conditions are met. These are: 1) the benefits provided under the health FSA are excepted benefits under HIPAA and are not subject to HIPAA's certification and other rules; 2) in the plan year in which the qualifying event occurs, the maximum amount that the health FSA could require to be paid for a full plan year of COBRA coverage equals or exceeds the maximum benefit available under the health FSA for the year.

IRS Notice 2005-42 (2005)

- Permitted employers to give employees up to an additional two and one-half months to spend down their flexible spending accounts after the end of the plan year.

Sources: Dale L. Gifford and Christine A. Seltz, eds., *Fundamentals of Flexible Compensation* (New York, NY: John Wiley and Sons, Inc., 1988); Charles D. Spencer & Associates, Inc., "IRS Issues 1989 Proposed Regulations for Cafeteria Plans, Flexible Spending Accounts," *Spencer's Research Reports* (January 22, 1993): 351-39–351-44; Hewitt Associates, *1992 in Review and the Outlook for 1993 Legislative/Regulatory Activity* (January 1993); Hewitt Associates, *1993 in Review and the Outlook for 1994 Legislative/Regulatory Activity* (January 1994), and Michael S. Melbinger, *Flex Plan Handbook* (Washington, DC: Thompson Publishing Group, 2006