

# The Effect of the Affordable Care Act and Recent Proposed Legislation on Flexible Spending Accounts

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The Patient Protection and Affordable Care Act (ACA) of 2010 contains provisions that severely reduce the attractiveness of Health Care Flexible Spending Accounts (FSAs). Meanwhile, recent proposed legislation seeks to increase FSAs usefulness and attractiveness. Trying to resolve these two conflicting schools of thought has led to a debate about the future of FSAs that is important for health care consumers and physicians alike.

## Introduction

The Revenue Act of 1978 created Health Care Flexible Spending Accounts (FSAs) as a way for consumers to reduce their out-of-pocket health care costs. FSAs are voluntary, employer-sponsored plans that allow employees to devote pre-tax dollars to an account, which they may spend down on qualified medical expenses without incurring taxes. The caveat is that any unused money still in the account at the end of the plan year is forfeited to the employer.<sup>1</sup> The reason for this “use it or lose it” provision is to prevent consumers from using FSAs as tax shelters.<sup>2</sup>

Before the ACA, examples of qualified medical expenses included: co-payments, dental care, hospital fees, prescription drugs, over the counter drugs, psychiatric care, and office visits.<sup>3</sup> Additionally, before the ACA, there was no legal limit on contributions to FSAs; any limits were placed by individual employers.<sup>4</sup> All of this may change. The ACA contains two provisions that potentially limit the attractiveness of FSAs to employees. The first provision eliminates over-the-counter (OTC) drugs from the list of FSA qualified medical expenses unless consumers have prescriptions for them.<sup>5</sup> The second provision caps the amount of money an employee can contribute to an FSA at \$2,500.<sup>6</sup> Taken together, these controversial provisions increase the amount of taxable income by: (1) disincentivizing employees from enrolling in FSAs and (2) limiting the amount of nontaxable income that can be contributed by those employees who still do enroll. As a

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<sup>1</sup> Ken McDonnell, *Flexible Spending Accounts*, <http://www.ebri.org/pdf/publications/facts/1003fact.pdf> (last visited Mar. 22, 2011).

<sup>2</sup> *New Bill Would End FSA “Use it or Lose it” Rule*, PR-USA (Mar. 20, 2011), [http://pr-usa.net/index.php?option=com\\_content&task=view&id=654188&Itemid=30](http://pr-usa.net/index.php?option=com_content&task=view&id=654188&Itemid=30).

<sup>3</sup> *FSA Eligible Expenses*, WageWorks, <http://www.wageworks.com/employee/health-care/expenses/fsa.htm> (last visited Mar. 23, 2011).

<sup>4</sup> McDonnell, *supra* note 1.

<sup>5</sup> The Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, § 9003, 124 Stat. 119, 854 (2010).

<sup>6</sup> The Patient Protection and Affordable Care Act, § 9005, 124 Stat. at 854-55.

result, the Joint Committee on Taxation estimates that these two provisions will generate \$18 billion in federal revenue through 2019.<sup>7</sup>

In response, Senator Kay Bailey Hutchinson of Texas and Representative Erik Paulsen of Minnesota have introduced companion bills that would repeal the ACA provisions affecting FSAs.<sup>8</sup> Meanwhile, in efforts to make FSAs more attractive to employees without repealing the two provisions in the ACA, Congressmen Charles Boustany of Louisiana and John Larson of Connecticut introduced the Medical Flexible Spending Account Improvement Act (Improvement Act).<sup>9</sup> The Improvement Act would end the longstanding “use it or lose it” requirement of FSAs by allowing employees to withdraw unused funds at the end of the plan year and have those funds counted as taxable income.<sup>10</sup>

### ACA’s Elimination of OTC Drugs Without Prescriptions from the List of FSA Qualified Medical Expenses

In September 2003, the Internal Revenue Services (IRS) issued a revenue ruling allowing OTC drugs to be included in the list of FSA covered medical expenses.<sup>11</sup> The ACA amended this ruling by requiring that employees, as of January 1, 2011, procure a prescription for OTC drugs in order for the drugs to be reimbursable through a FSA.<sup>12</sup> Supporters of this provision point out that households with FSAs overspend on unnecessary OTC medications near the end of the plan year in attempts to avoid forfeiting unused money in their accounts to their employers.<sup>13</sup> These supporters argue that removal of unprescribed OTC medications will not only curb this cavalier spending on health care, but will also reduce the amount of money employees put into FSAs initially, thus providing more taxable income and federal funding for other provisions of the ACA.<sup>14</sup> The Joint Committee on Taxation estimates that this provision will allow the federal government to raise about \$5 billion by 2019.<sup>15</sup>

Critics of the provision argue that the unintended consequences of the provision far outweigh any potential benefits. It appears that the provision is not in the spirit of the intended goals of the ACA because it effectively decreases access to care and increases

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<sup>7</sup> *Estimated Revenue Effects Of The Amendment In The Nature Of A Substitute To H.R. 4872, The “Reconciliation Act Of 2010,” In Combination With The Revenue Effects Of H.R. 3590, The “Patient Protection And Affordable Care Act (‘PPACA’),” As Passed By The Senate*, Joint Committee on Taxation, Mar. 18, 2010, available at <http://www.jct.gov/publications.html?func=startdown&id=3671>.

<sup>8</sup> Paul McDonnold and John Egan, *Political Leaders Press for Changes in FSAs and HSAs*, <http://www.insurancequotes.com/health-insurance-fsa-hsa/> (last visited Mar. 22, 2011).

<sup>9</sup> *New Bill*, *supra* note 2; see also H.R. 1004, 112th Cong. (2011).

<sup>10</sup> Medical Flexible Spending Account Improvement Act, H.R. 1004, 112<sup>th</sup> Cong. §2(a) (2011).

<sup>11</sup> McDonnell, *supra* note 1.

<sup>12</sup> PPACA, § 9003, *supra* note 5.

<sup>13</sup> Janet Adamy, *In Health Law, Rx for Trouble*, WALL ST. J., Mar. 9, 2011, at A1.

<sup>14</sup> Mr. Money, *Flexible Spending Account (FSA) Plan Changes and Limits in 2011 and Beyond*, <http://www.smartmoney.com/flexible-spending-account-fsa-plan-changes-and-limits-in-2011-and-beyond/>. (last visited Mar. 25, 2011).

<sup>15</sup> *Estimated Revenue Effects*, *supra* note 7.

the cost of care. The provision has the potential to decrease access to care by increasing wait times at doctors' offices since FSA holders will now be requesting prescriptions for OTC medications or asking for prescription drugs to replace their now more costly OTC medications.<sup>16</sup> Critics' fear of longer wait times is substantiated by a 2010 Nielsen survey which found that 46.3 percent of consumers with FSAs would request prescriptions for OTC medications as a result of the provision.<sup>17</sup> In an attempt to counteract the problem of longer wait times, some physicians have started imposing prescription fees ranging from \$5-\$10 per prescription.<sup>18</sup> Physicians feel this would reduce the number of requests for OTC drug prescriptions, but this also has the direct effect of increasing the cost of care. Proponents of the provision argue that physicians could save time and money by electronically prescribing OTC medications to patients, however many physicians refuse to prescribe anything without seeing a patient in person, for fear of malpractice liability, and prescribing the wrong medication<sup>19</sup>

The ACA's OTC medication restriction seems like a compromise gone wrong. Clearly, the drafters of the ACA are trying to limit the use of FSAs and the purchase of OTC medications. However, the drafters' attempt to leave the door open for patients who have chronic illnesses that require heavy use of OTC drugs. The problem with this compromise is that it imposes an undue burden upon physicians who are likely to see a spike in prescription requests. There is also an undue burden on patients who have to seek out a prescription every time they want to use FSA dollars on an OTC medication for an acute illness. These excessive burdens seem unnecessary considering the same goals of reducing cavalier spending on OTC drugs and increasing federal funding can be achieved with less burdensome reforms. The ACA's OTC medication restriction should either completely prohibit or completely allow employees from using FSAs on OTC medications. This prescription compromise is not really a compromise at all because it causes everyone to suffer.

### ACA's \$2,500 Cap

Before the ACA, employers were free to set contribution limits to FSAs.<sup>20</sup> For example, the federal government set a limit of \$5,000 for federal employees.<sup>21</sup> Beginning January 1, 2013, the ACA institutes a \$2,500 cap on the amount that can be contributed to FSAs.<sup>22</sup> This cap appears to be reasonable considering the average account balance in

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<sup>16</sup> Adamy, *supra* note 13.

<sup>17</sup> Dennis Callahan and Liz Yurkevicz, *Paying for OTC Medications – New Rules, Big Impact*, Nielsen Wire, (Jan. 27, 2011), <http://blog.nielsen.com/nielsenwire/consumer/paying-for-otc-medications-%E2%80%93-new-rules-big-impact/#>.

<sup>18</sup> Adamy, *supra* note 13.

<sup>19</sup> *Id.*; see also William Pewen, *Pre-Tax Purchase of OTC Drugs: A Prescription for Compromise*, Health Affairs (Mar. 21, 2011), <http://healthaffairs.org/blog/2011/03/21/pre-tax-purchase-of-otc-drugs-a-prescription-for-compromise/>.

<sup>20</sup> McDonnell, *supra* note 1.

<sup>21</sup> *Flexible Spending Accounts*, U.S. Office of Personnel Mgmt., [http://www.opm.gov/insure/new\\_employ/index.asp?AnswerId=138](http://www.opm.gov/insure/new_employ/index.asp?AnswerId=138) (last visited Mar. 25, 2011).

<sup>22</sup> The Patient Protection and Affordable Care Act, *supra* note 6.

FSAs is currently around \$1,400.<sup>23</sup> Critics of this provision point out that the cap will negatively affect those employees with chronic illnesses who spend much more than \$2,500 on FSA covered medical expenses.<sup>24</sup> However, proponents of the cap argue that the ACA makes it much easier for employees with chronic conditions to obtain affordable insurance since insurers can no longer use pre-existing conditions as a barrier to enroll in plans.<sup>25</sup> Moreover, proponents of the cap point to the large source of federal funding (Joint Committee on Taxation estimates \$13 billion by 2019) that will result from employees having more taxable income.<sup>26</sup> Furthermore, with less money in their accounts initially, fewer employees will be forced to hastily spend on unneeded medical products and services near the end of the plan year in order to exhaust high remaining balances in their accounts. This trade-off seems reasonable especially when coupled with a repeal of the longstanding “use it or lose it” aspect of FSAs.

### Repeal Use it or Lose it

The two ACA provisions likely signal the end of FSAs by severely limiting their attractiveness and usefulness. However, FSAs have proven over time to be an effective way for employees to limit expenditures on health care costs. An adequate compromise may be to repeal the OTC medication restriction provision, let the \$2,500 cap stand, and repeal the “use it or lose it” aspect of FSAs. Drafters of the proposed Medical Flexible Spending Account Improvement Act (Improvement Act) point out that the \$2,500 cap prevents employees from using FSAs as tax shelters, so the use it or lose it aspect of FSAs is no longer necessary.<sup>27</sup> The Improvement Act proposes that employees may withdraw unused FSA funds before the end of the plan year to count as taxable income, rather than forfeiting unused funds to employers.<sup>28</sup> The Improvement Act, in conjunction with the \$2,500 cap would satisfy the federal government’s objectives of eliminating unnecessary spending on medical products and services and providing federal funding for other aspects of the ACA. Meanwhile, the Improvement Act would make FSAs a viable option for employees seeking to limit medical expenses without having to worry about forfeiting unused money to their employers.

### Conclusion

The ACA’s requirement that employees obtain prescriptions before using FSA funds on OTC medications is flawed because it decreases access to care while increasing costs. Faced with more prescription requests, physicians must make the choice of either allowing longer waiting lines or charging for prescriptions. This is an undue burden for physicians and can only provide access and cost issues for patients. The government’s

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<sup>23</sup> Walecia Konrad, *Flexible Spending, a Little Less So*, N.Y. TIMES, Apr. 17, 2010 at B8.

<sup>24</sup> Joe Jackson, *Flexible Spending Account Restrictions Need Fixing*, Chronicle Editorials, (Nov. 21, 2010), <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2010/11/20/EDS21GDSUC.DTL>.

<sup>25</sup> Lea Winerman, *Health Care Reform: You Asked, We Found Answers*, PBS NewsHour (Mar. 23, 2011), <http://www.pbs.org/newshour/rundown/2011/03/health-care-reform-you-asked-we-found-answers.html>.

<sup>26</sup> *Estimated Revenue Effects*, *supra* note 7; *see also* Mr. Money, *supra* note 14.

<sup>27</sup> *New Bill*, *supra* note 2.

<sup>28</sup> Improvement Act, *supra* note 10.

goals of increased federal funding through income taxation and decreased spending on unnecessary medical expenses can be achieved much less harmfully by instituting the \$2,500 cap on FSA contributions and repealing the employer forfeiture aspect of FSAs. This compromise may not make everyone happy, but at the very least, it comports with the overall supposed goals of the ACA: affordability and access.

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