

Department of Legislative Services
Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 542

(Senator Rosapepe)

Budget and Taxation

**Protection of State Employees - Health Care Flexible Spending Account
Contributions**

This bill requires the Department of Budget and Management (DBM) to ensure that any contract entered into by the State on or after July 1, 2009, relating to flexible spending accounts (FSAs) includes a provision for the administrator to reimburse an employee with a health care FSA for any money forfeited by the employee because a request for reimbursement from the Health Care Account was not submitted by the filing deadline.

Until the effective date of a new contract, DBM must reimburse an employee for any money forfeited. The bill also requires DBM to notify each employee who has a Health Care Spending Account of the employee's right to, and the procedure for, reimbursement.

The bill takes effect July 1, 2009.

Fiscal Summary

State Effect: Significant increase in State expenditures beginning in FY 2010 due to the invalidation of the tax-favored status of the State employee benefits plan and reimbursements by DBM in FY 2010.

Local Effect: None. The bill only affects State government finances.

Small Business Effect: None.

Analysis

Current Law: The Internal Revenue Code states that unused balances cannot be returned to participants after the deadline has passed for reimbursements. Forfeitures may only be retained by the employer to defray administration expenses or allocated in a reasonable and uniform fashion back to all participants in the program.

Claims for reimbursement through an FSA must be made within the plan year when the expense was incurred. Employers are allowed to offer a grace period to employees. The grace period extends two-and-a-half months after the plan year ends.

Background: FSA is one of a number of tax-advantaged financial accounts that can be set up through a health plan with an employer. FSA allows an employee to set aside a portion of his or her earnings to pay for qualified expenses as established in the plan, most commonly for medical expenses, but often for dependent care or other expenses. Money deducted from an employee's pay into FSA is not subject to payroll taxes, resulting in a substantial payroll tax savings.

Reimbursing the employee irrespective of whether the employee incurred a covered medical expense during the plan year is a violation of federal law and invalidates the tax-favored status for all State health, prescription, dental, life insurance, and FSA spending account deductions under the State Employee and Retiree Health and Welfare State Benefits program.

State Fiscal Effect: *For illustrative purposes only:* DBM advises that, if enacted, this bill causes all active employees in the State benefits program, not just FSA participants, to have all pre-tax premium deductions included as taxable income for the entire plan year. For fiscal 2008, State employees received the pre-tax benefit on approximately \$175 million in deductions. Assuming invalidation of tax-favored status of Maryland's State benefits program is immediate, State employees lose this benefit and pay federal, State, and local taxes on those deductions. The State is required to contribute the employer share of the Federal Insurance Contributions Act (FICA) – 7.65% – taxes on those deductions. DBM estimates the impact beginning fiscal 2010 to be approximately \$13.4 million. This estimate does not include the additional tax burden placed on all employees enrolled in the health benefits program.

The first year of the new FSA administrator contract does not begin until fiscal 2011. Until then, the bill requires DBM to reimburse employees for any forfeited funds. Legislative Services cannot reliably estimate the amount of reimbursement owed to employees in the State under the bill, but the cost is expected to be significant in fiscal 2010.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Budget and Management, Department of Legislative Services

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