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Comments Submitted to the Senate Committee on Small Business and  
Entrepreneurship

## Comments Submitted to the Senate Committee on Small Business and Entrepreneurship

### Hearing on

#### **Solving the Small Business Health Care Crisis: Alternatives for Lowering Costs and Covering the Uninsured**

April 20 , 2005

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The Small Business Council of America (SBCA) is a national nonprofit organization that represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which are stable small businesses that provide health insurance and retirement plans for their employees. The SBCA is fortunate to have the leading small business advisors in the country on its Advisory Boards.

The American Society of Pension Professionals & Actuaries (ASPPA) is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of more than 5,500 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans, especially for small to mid-size employers.

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of over 60 trade and professional associations that share a common commitment to the future of small business. SBLC's members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. SBLC's policies are developed through a consensus among their membership.

The Employers Council on Flexible Compensation (ECFC) is a non-profit trade association committed to the study and promotion of defined contribution plans, 401(k) plans, cafeteria plans and elective compensation plans. Approximately 20 million Americans receive flexible benefits from the more than 2,800 ECFC members. Members are plan sponsors, corporations, governments, unions, universities and hospitals, as well as leading actuarial, administration, consulting, insurance and accounting firms that design and administer flexible benefit plans. Founded in 1981 by Fortune 500 corporations, Council members have great experience in designing and administering compensation and benefit programs that offer flexibility for employers and employees.

SBCA, ASPPA, SBLC and ECFC strongly endorse S. 723, the SIMPLE Cafeteria Plan Act of 2005, introduced by the Senate Small Business and Entrepreneurship Chair, Olympia Snowe (R-ME), and co-sponsored by Senators. Kit Bond (R-MO) and Jeff Bingaman (D-NM). We applaud their efforts to enable small business employees to purchase health insurance and other employee benefits through a tax-qualified vehicle. SBCA, ASPPA, SBLC and ECFC are in full agreement with Senator Snowe's comment: "It is unconscionable for Congress to do nothing while more and more Americans find themselves without health insurance. Establishing a SIMPLE Cafeteria Plan for small businesses will help them offer the same health insurance and savings options currently available to employees of large companies and government agencies."

This bipartisan legislation would enable small business owners and their employees to be able to purchase employer-provided health insurance and other benefits with pretax dollars. Specifically, it would amend the tax code so that owners of small businesses, including partners and S-corporation stockholders who own more than 2 percent of the stock, could participate in a cafeteria plan if they worked in the business. They are excluded under current tax law because they are not "employees," even if working full-time, but rather are self-employed individuals and thus ineligible by definition. This bill, if passed, would enable them and their non-owner employees to be able to purchase employer-provided health insurance with pretax dollars. A cafeteria plan is a flexible spending account created by section 125 of the Internal Revenue Code (IRC) that allows participants to pay their health insurance premiums and other employee benefit expenses through a tax-qualified plan.

Modeled after the effective 1996 Savings Incentive Match Plan for Employees (SIMPLE) pension plan, the new SIMPLE Cafeteria Plan would allow most small businesses, many of whom are currently unable to satisfy the existing nondiscrimination cafeteria plan rules due to their size. The new SIMPLE Cafeteria Plan would provide a safe harbor for satisfying the nondiscrimination rules, in exchange for making a required annual contribution of 2 percent or a matching contribution of 3 percent to their employees' accounts for health insurance and other employee benefits. These plans are highly valued by employees for their pre-tax allowance.

The measure would also permit the carryover of unused flexible spending accounts funds, as well as simplifying and increasing dependent care accounts for employers of all sizes. It would also allow cafeteria plans to offer long-term care insurance as an optional benefit for the employees to select. It eliminates the despised "use it or lose it" rule, which causes employees to have their own salary revert back to their employer if they do not spend as much money on medical care as they had anticipated. In effect, instead of being rewarded for being healthy (as is true with the Health Savings Accounts), the current rule causes employees to forfeit their own dollars to their employers because they did not need to spend those dollars on health care.

This bill has been over four years in fruition. In addition to SBCA, ASPPA, SBLC and ECFC, the U.S. Chamber of Commerce, the National Federation of Independent Businesses (NFIB), the National Small Business Association (NSBA) and others have worked to help the Small Business Committee develop this measure.

This legislation is important for all employees, but in particular for small business employees. This legislation will make it far easier for small business employees to be covered by a cafeteria plan the same way that employees for mid- and large-size businesses are currently able to do, so that small business employees will be able to select the benefits that they need most. Even more important, by giving the small business owners an incentive to sponsor cafeteria plans, this legislation will go a long way in helping small business employees afford health insurance.

- **Employees of big businesses, mid-size employers, non-profits, schools, universities and the federal government appreciate the valuable benefits provided by cafeteria plans. Cafeteria plans allow workers to obtain and choose employee benefits that are tailored to their needs in a tax-advantaged manner.** Cafeteria plans allow employees to pay their portion of health insurance on a pre-tax basis. They allow employees' payroll deductions to pay for their deductibles, co-pays, drugs, braces, eyeglasses, and other health care expenses, as well as dependent care, disability insurance and term life insurance. Workers are able to select the benefits that they need most and are able to save for these expenses by electing to have funds removed from their paychecks. This is the easiest way for employees to save for these necessary expenditures—note the dramatic success of employees saving for their retirement through 401(k) plans. **It is clear that cafeteria plans offer a successful approach to encourage employee participation in healthcare costs.**
- **Small businesses are at a double disadvantage when it comes to offering health care and other employee benefits to their employees. Their health care insurance premiums are higher**

because small businesses lack the bargaining power of larger businesses. Because most small businesses do not offer cafeteria plans, small business employees are not able to pay for their health care and other benefit expenditures on a pre-tax basis.

- **Employees of small businesses are seldom offered this valuable benefit because many small business owners are precluded from participating in a cafeteria plan. Small business owners who operate in any entity other than a C Corp (or those that own less than 2 percent in a Sub-S corp) are not allowed to be covered by a cafeteria plan.** When small business owners cannot take advantage of the benefits offered by a cafeteria plan, they seldom have any interest in sponsoring such a plan. Even for those small business owners that are allowed to participate (e.g., a less than 2 percent stockholder in an S Corp or an owner in a C Corp), the existing nondiscrimination rules effectively preclude the owners from being able to use the plan except for de minimis amounts. Again, if the owners of a small business cannot benefit from the plan to a meaningful degree, it is not likely to be offered.
- **The legislation would create a safe-harbor cafeteria plan that would be modeled after the successful SIMPLE retirement plan model.** If a small business contributes a safe harbor contribution of 2 percent or matches employee contributions up to 3 percent of the employee's compensation, then in exchange for this required contribution, none of the nondiscrimination tests applicable to cafeteria plans and dependent care plans would apply.
- **This legislation would provide small business employees access to cost savings.** The SIMPLE retirement plan has demonstrated that small businesses are willing to absorb some additional cost for employees through contributions in exchange for relief from complex administration and discrimination tests. It is anticipated that the safe-harbor cafeteria plan patterned on the SIMPLE retirement plan would also be accepted and adopted by small business. **Millions more small business employees would be likely to have health care insurance through the SIMPLE Cafeteria Plan, with some portion of the premium paid for by the employer and the remainder being paid for by the employee. Small business employees would also be able to select from other benefits that are most needed.** Congress has already decided that the SIMPLE plan provides sufficient benefits for the non-owner employees to justify the contributions for the owners—this SIMPLE Cafeteria Plan is patterned on the SIMPLE model and can bring valuable employee benefits, most importantly health insurance to small business employees.
- **The proposed legislation would allow cafeteria plans to provide employees with long-term care insurance.** Presently this valuable employee benefit is not allowed to be offered by a cafeteria plan. By allowing employees to purchase this valuable benefit on a pre-tax basis by payroll deduction, it is far more likely that employees will elect long-term care coverage. **This change would encourage more employees to finance their own long-term care, which shifts more of the burden of providing for the long-term care needs to individuals rather than the government.**
- **The proposed legislation would do away with the despised "use it or lose it" policy now applicable to flexible health care accounts.** If an employee has overestimated the amount of health care expenditures that he or she will have to pay during the year (over and above those paid by health insurance), then the excess amount is forfeited to the employer. Employers are currently prohibited from bonusing this amount back to the employee. Some employers apply these forfeited amounts to benefits for all the employees in the following year, but there is no requirement that they do so. Theoretically, the policy behind this unpopular rule created by the IRS was to make the flexible health care account more like an insurance policy. It is hard to imagine any insurance policy being purchased where the risk is limited to the amount of "premiums" paid and the "insureds" forfeit their own money if they cannot come up with enough expenses. Thus, comparing the "use it or lose it" rule of a medical reimbursement account under a flexible spending arrangement to health insurance (or any other kind of insurance) is unreasonable. The use it or lose it concept is unfair to

employees and runs counter to public policy inasmuch as employees generally will not save as much as they are able to pay for health care expenditures because they are fearful of forfeiting their own money (their savings for health care expenditures) to their employer.

- **This legislation would change the nature of the health care flexible spending account to a reimbursement account so that it is similar to the dependent care account (the difference being that a cafeteria plan may reimburse the full elected amount during the year, while a dependent care may only reimburse the account balance). The legislation would also cap the amount of the health care flexible spending account as dependent care accounts are capped. Similar to the President's proposal, the legislation would allow any funds left over in the health or dependent care flexible spending account at the end of the year to be rolled over to a 401(k) account (or other qualified retirement plan vehicle), an HSA or carried over to the next year. Finally, employees terminating employment would be permitted to cash out their accounts, though doing so would subject the distribution to income tax.**
- **These changes would encourage employees to select the appropriate amount required for health care expenditures rather than possibly choosing to estimate low so that they do not forfeit their own money to their employer. This would assist employees in dealing with rising health care costs and provide a vehicle for employees to save for these expenditures in a tax-free manner.**
- **The legislation would revise the discrimination tests applicable to the dependent care flexible spending account to enable all employees to use the benefit. The dollar amount would be increased to take into account today's cost of providing care for dependents.**

Small business employees are in need of access to health care in a cost effective manner. Congress understands how vital health care is for our citizens and has decided that individuals should be incentivized to undertake as much of the burden of providing for this health care as possible. S. 723 does this—small business employees would now be able to join their counterparts in mid-size and large businesses and save for health care and other employee benefits in a tax advantaged manner. Furthermore, all employees, regardless of the size of the entity they work for, should be able to have access to the same benefits under the tax code. Also, the initial cost of providing access to long-term care insurance in a tax advantaged manner is outweighed by employees taking ownership of the problem and financing their own long-term care. When it comes to health care the primary issue should not be short-term loss of revenue, but access to quality health care at the most reasonable price possible for the largest number of Americans possible.

Interestingly, this revenue argument is being advanced by a number of Senators in conjunction with contemplating the repeal of estate taxes—something that not only will hurt a great number of small businesses because of the loss of the step-up in basis but will also be a huge revenue drain on the country. If we have the funds to assist roughly 0.3 percent of the individuals in the country (this translates to 8,500 people) to leave enormous wealth to their families, then surely there must be money to help millions and millions of small business employees to gain access to health care insurance and other needed employee benefits.

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