

Comments Submitted to the Senate Finance Committee

Hearing on Tax Incentives for Businesses in Response to a Minimum Wage Increase

January 10, 2007

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates the opportunity to submit our comments to the Senate Finance Committee's January 10, 2007, hearing titled "Tax Incentives for Businesses in Response to a Minimum Wage Increase." In particular, ASPPA supports the Savings Incentive Match Plan for Employees of Small Employers Cafeteria Plan Act of 2005 (SIMPLE Cafeteria Plan),¹ introduced in the 109th Congress, which would enable small businesses to purchase employer-provided health insurance and other benefits with pre-tax dollars.

ASPPA is a national organization of approximately 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unusual insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

Background

There are 46 million uninsured Americans, and over 60 percent of these Americans work for (or are family members of) small businesses. Only 42 percent of businesses with less than 50 employees offer health insurance to their employees, and these workers are three times as likely to be without health insurance as workers in large firms.

Of the 25 million Americans who own a small business, 10 million are primarily self-employed (*i.e.*, have no common-law employees). Small business owners in recent years have typically seen a 20 percent increase in their health insurance costs. According to a

¹ On April 6, 2006, Senators Olympia Snowe (R-ME), Kit Bond (R-MO) and Jeff Bingaman (D-NM) introduced the "SIMPLE Cafeteria Plan Act of 2005" (S. 723) that would, among other things, allow small employers to set up SIMPLE cafeteria plans for their employees.

survey by the National Federation of Independent Business, the most critical issue for small businesses is their cost and availability of health insurance.

Opening Cafeteria Plans to Small Business Owners

Currently, employer-sponsored IRC Section 125 plans (cafeteria plans) allow participants to pay for health insurance coverage, dependent care costs (IRC Section 129) and out-of-pocket medical expenses (IRC Section 105) on a pre-tax basis. Cafeteria plans allow employees to obtain and pay for, on a pre-tax basis, employee benefits, such as deductibles, co-pays, drugs, braces, eyeglasses and other health care expenses, as well as dependent care, adoption expenses, and group term life insurance. These important tax breaks currently allow many Americans, who would not otherwise have the opportunity, to obtain health coverage. The tax savings can be as much as 30 percent. An example of saving on a pre-tax basis is the dramatic success of employees saving for their retirement through 401(k) plans.

While employees of big businesses, mid-size employers, non-profits, schools, universities and the federal government appreciate the valuable benefits provided by cafeteria plans, small business owners are presently precluded from participating in cafeteria plans. Under current law, cafeteria plans can be utilized by common-law employees but not by:

- Sole proprietors.
- Partners in a partnership.
- S-corporation 2% or more shareholders (and by attribution, their family members).
- Limited liability corporation and partnership members.

Their inability to participate is due to language in IRC Section 125 that limits participation to “employees” without further language allowing self-employed individuals to participate. As a result, without the small business owner able to participate in cafeteria plans, employees of small businesses are seldom offered this valuable benefit.

SIMPLE Cafeteria Plans

ASPPA encourages the Senate to incorporate the SIMPLE Cafeteria Plan into the minimum wage legislation, the Small Business and Work Opportunity Tax Act of 2007 (S. 2).² The SIMPLE Cafeteria Plan would enable small business owners and their employees to purchase employer-provided health insurance and other benefits with pre-tax dollars.

The SIMPLE Cafeteria Plan amends 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 for the business. As stated previously, such persons are excluded under current tax law because they are not

² S. 2 was passed by the Senate Finance Committee on January 17, 2007, and contains an increase to the minimum wage and various small business tax provisions.

“employees” (even if working full-time) but rather are self-employed individuals and thus ineligible by definition.

The SIMPLE Cafeteria Plan, modeled after the effective 1996 SIMPLE Pension Plan, would benefit small businesses that are currently unable to satisfy the existing nondiscrimination cafeteria plan rules due to their size. The 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 the administration of, and increasing the amounts contributed to, dependent care accounts for employers of all sizes. It would also allow cafeteria plans to provide for long-term care insurance as an optional employee benefit. It also eliminates the despised “use it or lose it” rule, which causes employees’ salaries to 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 dollars to their employers because they did not need to spend their cafeteria plan dollars on health care. This discourages full participation by many employees, despite the tax benefits.

The SIMPLE Cafeteria Plan is important for all employees, but in particular for small business employees. It will make it 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 covered. The result is that small business employees will be able to select and budget for the benefits that they need most. Even more important, by giving *all* small business owners an incentive to sponsor cafeteria plans, the legislation will now be helping small business employees afford health insurance. Furthermore, *all* employers should be provided with equal access to benefits under the tax code.

We have attached S. 723 to these comments for your consideration.

Recommendation

ASPPA recommends that the Senate incorporate the SIMPLE Cafeteria Plan (S. 723 from the 109th Congress) in the Small Business and Work Opportunity Tax Act of 2007 (S. 2). The SIMPLE Cafeteria Plan would enable small business owners and their employees to purchase employer-provided health insurance and other benefits with pre-tax dollars.

Small business employees need greater access to cost-effective health care. Congress understands how vital health care is for Americans and has incentivized individuals to undertake as much of the burden of providing for their health care as possible. The SIMPLE Cafeteria Plan 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.