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# United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

August 23, 2004

The Honorable John W. Snow  
Department of Treasury  
1500 Pennsylvania Ave.  
Washington, D.C. 20220

Dear Secretary Snow:

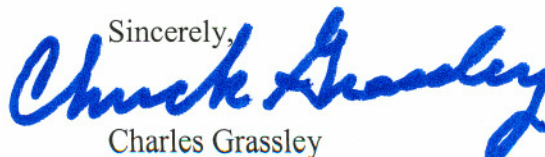
I am writing with regard to the so-called “use it or lose it” rule that applies to health flexible spending accounts (FSAs). As you know, section 125 of the Internal Revenue Code permits employees to contribute at the beginning of the year to an FSA in lieu of other forms of compensation. Then, as out-of-pocket (i.e., not covered by insurance) health expenses are incurred, the employee may pay for them out of the FSA with pre-tax funds. Under proposed section 125 regulations, the employee forfeits unused FSA balances at the end of the year to the employer (the “use it or lose it” rule).

The Administration advanced proposals to modify the “use it or lose it” rule in the Treasury Department’s FY2002, FY2003, and FY2004 budget proposals. I believe that there are strong policy justifications for taking such action. First and foremost, I am aware of no other area of benefits law in which we allow – let alone mandate – that employee dollars set aside for benefit expenses revert back to the employer. The current rule unjustly enriches employers at the expense of hard-working employees who participate in FSAs. In addition, the “use it or lose it” rule causes inefficient allocation of health care dollars by providing an incentive for employees to incur unnecessary health care expenses at the end of the year to use up the account. Of course, the “use it or lose it” rule also has the effect of dramatically reducing employee participation in FSAs because employees do not want to risk forfeiting or wasting their hard-earned money.

I know that a variety of legislative proposals have been advanced to modify or eliminate the “use it or lose it” rule. However, I would urge the Treasury Department to examine closely its authority to modify the “use it or lose it” rule administratively. Since the “use it or lose it” rule was created administratively – and was done so through proposed regulations that have never been finalized – it would seem that the Treasury Department does have such authority. I have heard from numerous Iowans in my home state and from taxpayers across the country that the “use it or lose it” rule makes no sense. Modifying this rule would help millions of Americans meet their health care expenses and make the FSA rules more rational.

Thank you in advance for your consideration of this letter. I look forward to your response. If you have any questions or I can provide any additional information, please contact me or John O’Neill on my Finance Committee staff at (202) 224-4515.

Sincerely,



Charles Grassley  
Chairman, Finance Committee