Better together: Dependent care FSA + health care FSA

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Powerful benefits combo is a financial stepping stone for working parents

It's a reality that most employers today are recalibrating their benefits packages to better match a post-pandemic world. Nearly all (95%) human resources leaders and professionals are adjusting their companies' benefits strategies, and almost half (47%) are cutting benefits, according to caregiver marketplace Care.com's "2023 Future of Benefits Report", which surveyed 500 human resources and business leaders. As companies pare back some offerings, they are under enormous pressure to invest their dollars wisely, in order to best support employee productivity and retention in a turbulent labor market. In this environment, plan sponsors and benefits brokers can make a highly compelling case for employers to consider offering both dependent care flexible spending accounts (DCFSAs) and health care flexible spending accounts (FSAs).

Skyrocketing child and senior care costs

One class of benefits stands out as a particular priority at this moment: Dependent care benefits. Child and adult care benefits trailed only retirement benefits in popularity in 2023. Nearly half (46%) of companies surveyed prioritized child care benefits and 43% prioritized senior care benefits, Care.com reported.

Sky-high child care costs are a critical concern for many American workers, so it's no surprise that employers are seeing positive effects from benefits that support employees' dependent care needs. For an astonishing 59% of working parents, child care costs topped $18,000 a year per child. That outsized yet necessary budget item often makes it next to impossible for families to build up any sort of emergency savings or nest egg. The U.S. Department of Health and Human Resources considers child care to be affordable when it is less than 7% of family income. But Care.com found that day care expenses eat up an average of 27% of family income.

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It’s not only child care that strains working Americans, but also senior care. An estimated 18% to 22% of the U.S. labor force are family caregivers, and the majority of them (61%) find caregiving disrupts their employment — 53% reported having to start work late or leave early because of caregiving responsibilities, 15% reduced their work hours, and 14% took a leave of absence, according to a 2022 report, “Invisible Overtime,” from the Rosalynn Carter Institute for Caregivers.

With financial wellness being an integral part of overall employee wellness, dependent care FSAs are a win-win for employers and employees alike. Dependent care FSAs help employees reduce their tax bill while better managing their child care or elder care expenses and could thereby increase retention and reduce stress. Employees can use the pretax dollars toward children’s day care costs, day camp fees, and more — and can also use them toward care costs for a disabled spouse, elderly parent, or a dependent incapable of self care.

Only 39% of private industry workers had access to dependent care FSAs in 2021, the latest year for which data is available from the U.S. Bureau of Labor Statistics. Employers who offer this valuable benefit contribute to the financial health and peace of mind of their workforce — and are likely better-positioned to recruit talent in a competitive labor market.

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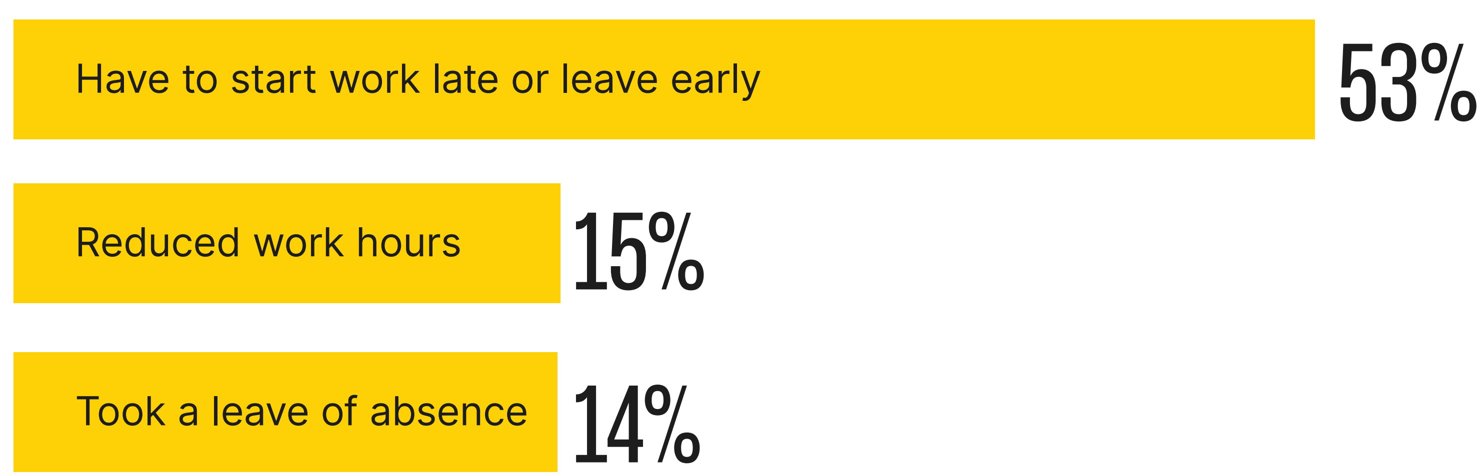
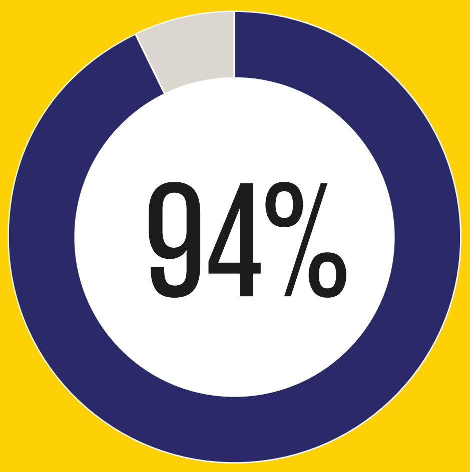


Rising medical expenses a major stressor

Alongside child care and elder care, rising medical expenses continue to be an enormous stressor for many working families. About a third (32%) of U.S. adults are health care "cost insecure," meaning they were unable to pay for needed care or medication, according to a West Health-Gallup poll. Another 7%, or 18 million American adults, were categorized as "cost desperate," meaning that they would not be able to pay for affordable quality care if they needed it today, and the majority (94%) of this group said health care costs are a daily source of stress, the report said.

Employers that offer health care FSAs help alleviate these worries for their workforce. "A health care FSA is extremely beneficial for those who worry about how they will pay for care or for those who have yearly medical expenses," says Diana Doerneman, reimbursement product manager at Inspira Financial.

"With the health care FSA, all the dollars are available at the beginning of the year. The funds are gradually paid back through payroll contributions. It's essentially an interest-free loan for your health care that is incrementally paid back with each payroll cycle. Having the funds up front provides flexibility for how medical expenses are paid, which can reduce the stressors for working families."



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Here's a closer look at the features of dependent care FSAs and health care FSAs

Key features of a dependent care FSA

A dependent care FSA lets employees set aside pretax dollars toward the costs of child and adult dependent care. The maximum IRS annual contribution is $5,000 per household, or $2,500 per individual if married and filing taxes separately. Contributions are automatically deducted from each paycheck and become available as they are contributed.

Eligible expenses include preschool fees, day care costs, nursery school, before- and after-school care, and summer day camp, as long as the purpose is allowing the employee, and any spouse, to work or seek work. Adult day care and in-home care costs are also reimbursable for an adult dependent or spouse incapable of self-care, as long as the expenses are to allow the accountholder and any spouse to work. Many of these costs are predictable, recurring costs, though some eligible expenses can be irregular.

This account helps employees prioritize the care of dependents, including:

- Children or dependents under age 13
- Other dependents, such as elderly parents, who require care and live in the same home as the DCFSA accountholder.
- A disabled spouse who lives in the same home and requires care

Employers can choose to make a pretax contribution toward employee dependent care expenses, or they can offer a dependent care subsidy that would apply toward the IRS annual limit of $5,000.

Key features of a health care FSA

With a health care FSA, employees enjoy a tax break on eligible out-of-pocket health expenses, along with the peace of mind of knowing how they'll manage their medical expenses. Employees choose a voluntary contribution amount for anticipated health expenses, up to a limit of $3,200 for the 2024 plan year. Then, contributions are automatically deducted from each paycheck, while the full elected amount is available to them from the beginning of the year. Eligible expenses include:

- Copays for doctor visits
- Coinsurance
- Deductibles
- Prescription medications
- Over-the-counter health items
- Dental and vision expenses

Employers also save, as they do not pay Social Security and Medicare payroll taxes on their employees' payroll contributions.

Health care FSAs take a lot of stress off the plates of working parents who are worried about out-of-pocket costs in case of illness or injury. Unlike with dependent care FSAs, budgeted health care FSA funds are available for the employee to use starting on the first day of their plan year. Typically, the health care FSA comes with a debit card, and employees get the peace of mind of being able to pay for qualified expenses as they arise with a swipe of their card. For flexible spending accounts without a debit card, the employee only needs to pay out of pocket momentarily, then submit a claim for reimbursement.

Having a health care FSA reduces the risks of unexpected medical debt or running up high-interest credit card balances. It also assists with budgeting. If the employee is able to pay for health care expenses out of pocket, he or she could strategically wait to claim eligible expenses at the end of the quarter or the year. That way, their lump sum reimbursement becomes an opportunity to direct money toward financial goals.

Utilize both a dependent care FSA and a health care FSA for a winning strategy

Dependent care FSAs and health care FSAs are investments in employee wellness and productivity. Offering such benefits can greatly assist employees in managing child care and health care costs, reducing financial stress and minimizing issues that tend to compromise employees' ability to be present and engaged at work.

Financial education is an important part of helping employees in making the most of their benefits. For working parents who are starting on their financial goals, combining both the dependent care FSA and health care FSA can provide a stepping stone toward better budgeting, and ultimately to building savings.

Signing up for a health care FSA not only sets users up for tax savings, but also encourages them to anticipate their health care costs and take responsibility for planning for them. They can elect to contribute an amount based on their average out-of-pocket responsibility for expected dental, vision, medical, and prescription drug expenses. "Electing these accounts allows accountholders to have the tax-free funds up front at the beginning of the plan year. It reduces taxable income and helps avoid placing these expenses on a credit card with high interest rates," Doerneman says. "It also puts the funds out of sight, which allows them to save for planned or unexpected health care costs. The funds are accumulating tax-free to be reimbursed for eligible expenses later within the plan year."

"The health care FSA is also great if you don't have the cash flow to pay for everything out of pocket because the entire election is available at the beginning of the plan year," she says, relieving working parents of worries about paying for unexpected medical bills.

Working parents can also leverage the dependent care FSA to better manage their child care costs. Even if they elect the maximum contribution of $5,000, their annual costs are likely to exceed that amount. Parents can certainly choose to file their claims for reimbursement as they incur care costs throughout the year. However, to the extent they can afford to, they can strategically give their budgets a boost by waiting until the end of the year to be reimbursed for day care fees by making one large claim for, say, $5,000.

For lower- to middle-income earners, the lump sum could be directed in various ways to improve their financial stability, such as:

- Child care costs for the coming year
- Pay any past-due bills from expenses incurred during the plan year
- Save for the future

How one mother used a dependent care FSA and a health care FSA to build savings

Doerneman has first-hand experience with using both dependent care FSAs and health care FSAs as vital financial tools to assist her household budgeting and, over time, to build up savings. As a single mother of two, she enrolled in a health care FSA to cover her children's health care costs. Initially, the amount she elected wasn't large, but it gave her peace of mind and minimized her stress when one of her boys became ill. "I knew I had my health care FSA debit card that could be swiped for those unexpected needs," she says.

She also enrolled in a dependent care FSA. That first year, she made it a point to set aside her federal tax refund, designating those dollars to offset the automatic contributions that were taken out of her paycheck.

As she incurred eligible expenses — such as child care fees for her boys — she paid those bills out of pocket as much as possible. That allowed her to avoid dipping into the dependent care FSA funds. Leaving the money in the tax-advantaged account until the end of the plan year, to the extent that she could afford to, was the first step toward building an emergency fund. In essence, the dependent care FSA acted as a tool to put her savings on auto-pilot. At the end of the year, she filed her claims, receiving a lump sum reimbursement from her dependent care FSA.

Getting that $5,000 payout was a stepping stone in her financial progress. Each year, she was able to deploy that nest egg toward her financial goals — including an emergency fund and a savings account. Each year, she repeated the process, and her savings grew.

"Eventually, this cycle turned into me having a savings account, another account to save for my future health care needs, and an emergency savings account for those unexpected situations," says Doerneman.

Flexible spending accounts are powerful financial tools that can multiply in benefits when used strategically. By providing these benefits, employers can help employees stabilize household budgets, provide for child care and gain peace of mind for health care expenses.

Which benefits are right for your employees?

To learn about the best options for dependent care FSAs and health care FSAs, and which flexible spending accounts are suitable for your employees, visit inspirafinancial.com/business/health-benefits/health-care-fsa and inspirafinancial.com/business/health-benefits/dependent-care-fsa.