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"Sick Day" HSAs: A Better Idea than Mandated Sick Pay

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President Obama recently proposed requiring employers to pay sick leave to the estimated 43 million American workers who not receive this benefit.[1] Many of these workers cannot afford unpaid sick days to for an illness or to care for a sick child.

Dallas Headquarters:
14180 Dallas Parkway, Suite 350
Dallas, TX 75254
972.386.6272

www.ncpa.org

Washington Office:
600 Pennsylvania Ave., SE
Suite 310
Washington, DC 20003
202.830.0177

National Center for Policy Analysis

However, the President's solution — requiring seven days of paid sick leave annually — will raise the cost of employing these workers, potentially reducing their pay and job prospects. Instead, the president could have proposed expanding health savings accounts (HSAs) to help workers replace income lost due to illness.[2]

Bad Idea: Mandating Sick Pay. Mandating paid sick days may sound benevolent, but it would hurt the people it is intended to help. Of the estimated 100 million jobs that provide some paid sick leave, many provide less than seven designated days annually.[3] A recent survey of employers by the Society for Human Resource Management found the proportion of firms that provide dedicated sick days about equals firms providing paid days off that can be used for either illness or leisure.[4] Paid sick leave varies by firm size, and also tends to increase with employee tenure.

The president's proposal also ignores a fact economists have long known: mandatory benefits are not free. Academic research by White House health adviser Jonathan Gruber in the 1990s confirmed workers themselves pay the cost of mandatory benefits through lower wages.[5] Thus, if employers are forced to provide paid sick days, they will adjust workers' future pay downward, or cut back paid vacation days or holidays, so that total compensation costs do not increase.[6]

Fringe (and mandatory) benefits are just one portion of total compensation. Many workers willingly forgo higher cash wages for other types of employee benefits. For instance, many workers prefer to spread 50 weeks of pay over the 52-week year, allowing them to take 10 vacation days and still receive a paycheck for the two weeks they don't work. Paid vacation days are not free; they merely allow workers to smooth their cash flow. Paid sick leave is similar.

Mandating paid sick days could even harm the employment prospects of workers most likely to stay home and care for a sick child: low-income, single mothers with small children. Gruber found the intended beneficiaries of mandated benefits may be less likely to be hired.[7] Indeed, small employers and firms that employ large numbers of low-income workers are less likely to offer paid time off work.[8] [See the table.]

Why Pay for Sick Leave? What determines who gets paid sick leave and who does not? It is not as simple as whether or not an employer is altruistic or stingy. As the previous discussion suggests, paid sick days are a function of workers' preferences. Some workers willingly accept jobs with lower take-home pay because they prefer fringe benefits over higher cash wages.[9] These often include sick pay. Other workers take jobs that lack fringe benefits because they prefer higher pay. Consider: Two weeks of vacation plus seven days of paid sick time amounts to 136 hours of lost productivity each year. A worker earning $15 per hour pay may prefer an additional $2,040 in gross pay (136 x $15) to 17 days of paid time off for illness or leisure.

Indeed, an employer would have to reduce this worker's pay 2.7 percent (56/2,080) to compensate for seven days of paid sick leave. For a worker making $15 per hour, seven days of paid sick leave is potentially worth $840 in additional gross pay (56 x $15).

HSAs for Sick Days. A better option is to allow workers themselves to decide how many sick days they need, and save for them in an account that can also be used for medical expenses.

Making deposits throughout the year and then withdrawing funds from an HSA to replace income lost during unpaid sick leave is already legal under current law, but such withdrawals are taxed and penalized as "nonqualifying" expenses. For example, assume an employer provides workers with a health plan with a high deductible of $3,000. Employers could also deposit $1,000 in an HSA to use for medical expenses below the deductible and/or for use as income replacement for sick days. Workers would be free to add their own pretax funds to the account.

Both the employer's and employees' HSA contributions may be used for Internal Revenue Code section 223 medical expenses, tax free and without penalty.[10] The accumulated funds could also be rolled over year after year for future medical needs; or the funds could be legally used for (non-qualifying) income replacement for sick days. Depositing funds that allow workers the flexibility to decide when to use them could avoid the perverse incentives associated with "use-it-or-lose-it" paid sick days. Funds withdrawn to reimburse income lost for sick days necessarily require forgoing their use for other medical expenses.

The advantage of using HSAs to fund sick days is its administrative simplicity: an employer could easily add a *Sick Day* benefit to an existing employee HSA plan. Unfortunately, the penalties on such nonqualifying withdrawals amounts to a total loss of 20 percent to 45 percent (or more) of the funds withdrawn.[11] If a worker needs to take an (unpaid) sick day off work — losing, say, $200 in gross pay, under current law a worker with an HSA could write himself or herself a check for $200 from the account. But the net revenue (after taxes and penalties) would amount to only about $110. Depending on the worker's marginal tax rate, about $90 dollars would be owed to the IRS.[12] Prior to the Affordable Care Act, the penalty for nonmedical use was only 10 percent — plus ordinary income tax.

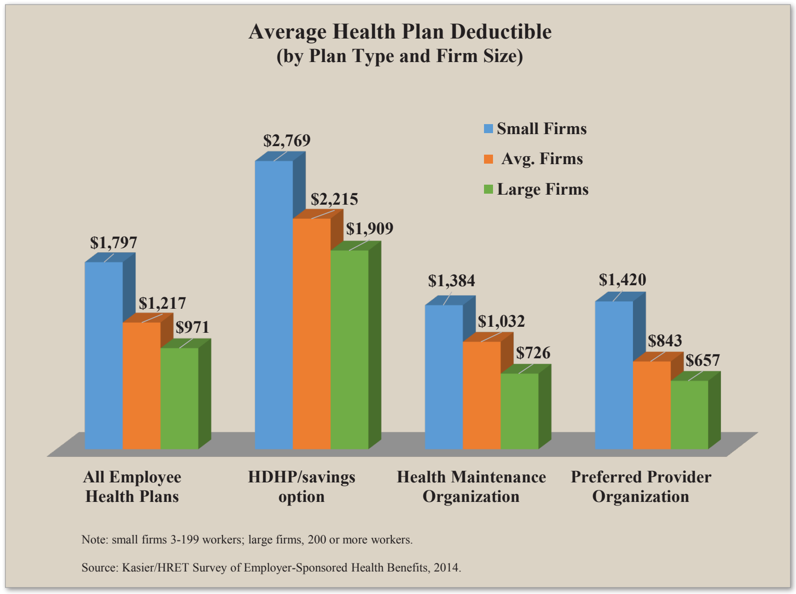
Moreover, under current law, seniors age 65 withdrawing HSA funds do not face the 20 percent additional penalty for nonmedical use. Seniors are allowed to use their HSAs for any expense (without penalty) merely by paying ordinary income tax on the funds withdrawn. It makes sense to extend the same courtesy to sick workers.

Making Sick Day HSAs Better. With a few small changes to federal

Paid Time Off Work

	Paid Sick Days	Paid Vacation	Paid Holiday
All workers (civilian)	65%	74%	75%
Full-time	78%	87%	87%
Part-time	25%	34%	36%
Lowest 25% pay dist.	34%	51%	50%
2nd quartile pay dist.	68%	82%	83%
Firm Size			
1-50	51%	66%	67%
50-99	58%	75%	73%
100-499	68%	79%	79%
500+	85%	78%	83%

Source: "Employee Benefits in the United States – March 2014," Bureau of Labor Statistics, July 2014.



law, Congress could increase access to HSAs for those who need them. The language of the current law excludes many workers from getting an HSA through their job. And many others — including many of those who have selected bronze plans through the state and federal health exchanges — don't realize their exchange plan qualifies for an HSA, because their insurers did not disclose that fact.

The minimum health plan deductible to qualify for an HSA allowed under federal law is $1,300 in 2015. According to a national survey, the average deductible for single coverage in employer plans was $1,217 in 2014. [See the figure.] Yet 61 percent of workers employed at small firms are enrolled in health plans that have a deductible of $1,000 or more.[13] This suggests millions of workers are either eligible (or on the verge of eligibility) for an HSA.

One way to allow more workers to save for sick days — while taking advantage of HSAs to cover higher, out-of-pocket medical copays (typical of bronze exchange and many employer plans) — is for Congress to expand opportunities to open an HSA. One proposal would allow individuals to open an HSA and deposit tax-free funds equal to their deductible. The Obama administration could also require exchange plans to disclose whether or not they are eligible for HSAs.

More Ways to Save for Medical Needs. Millions of workers have Flexible Spending Accounts (FSAs) for medical bills below their deductible, and expenses like eyeglasses or dental care not covered by insurance. Having unused dollars in an FSA precludes eligibility for a HSA. It would also be wise for Congress to allow people to roll over unused FSA funds into HSAs.

Finally, exchange insurers should be allowed to offer plans that incorporate an HSA owned by the enrollee with a bronze plan (or the proposed copper plan), that is partly funded with some of the federal subsidy dollars. Individuals could deposit additional funds for copays, coverage gaps and costs below the deductible. Enrollees would initially use HSA funds to pay for doctor visits, generic drugs, a few lab tests, and so forth until they exhaust their HSA or meet their deductible. Depending on their HSA balance, enrollees might experience a coverage gap if they exhaust the HSA prior to meeting their deductible. Once the deductible is met, enrollees would face typical cost-sharing.

Currently, people have the option of depositing additional funds into their HSA up to the limit allowed by law. This is especially beneficial for those with chronic illness, who often experience high medical bills. In 2015, individuals are allowed to deposit $3,350 ($6,650 per couple) tax-free. Those 55 years or older can deposit an additional $1,000 annually.

Under the Affordable Care Act, health plans may not impose either annual or lifetime limits on benefits. This makes health coverage premiums more expensive than if insurers were allowed to offer less comprehensive benefits. Many people may prefer a health plan that includes cash HSA benefits for their initial out-of-pocket costs, but has an annual or lifetime limit on benefits. Insurers currently do not have the flexibility to design plans enrollees prefer — but they should.

Conclusion. Congress should expand HSA eligibility to all workers, and allow their use to fund a wide variety of medical needs. Because workers themselves bear the cost of their own fringe benefits, why not give them tools to manage the trade-off between wages and income lost to sick days? Allowing all workers to set aside funds in an HSA to replace income lost to sick days would allow them to reclaim those funds for nonmedical purposes when a sick day isn't used, or to save for medical bills below their deductibles (tax free). Employers would also be free to add funds to the HSA if they choose.

Devon M. Herrick is a senior fellow with the National Center for Policy Analysis.

Notes

[1.] Office of the Press Secretary, “Remarks by the President in State of the Union Address,” The White House, Press Release, January 20, 2015. Available at http://tinyurl.com/mp3tjpb.

[2.] For an explanation of health savings accounts, see Devon Herrick, “A Brief History of Health Savings Accounts,” National Center for Policy Analysis, Brief Analysis No. 791, December 9, 2013. Available at http://www.ncpa.org/pdfs/ba791.pdf.

[3.] “Paid Time Off Programs and Practices: A Survey of WorldatWork Members,” WorldatWork, May 2010. Available at http://www.worldatwork.org/adimLink?id=38913.

[4.] Shawn Fegley et al., “Examining Paid Leave in the Workplace,” Society for Human Resource Management, April 2009. Available at http://www.shrm.org/research/surveyfindings/articles/documents/09-0228_paid_leave_sr_fnl.pdf.

[5.] Jonathan Gruber and Alan B. Krueger, “The Incidence of Mandated Employer-Provided Insurance: Lessons from Workers’ Compensation Insurance,” National Bureau of Economic Research, Working Paper No. 3557, December 1990. Available at http://www.nber.org/papers/w3557.pdf.

[6.] An increasing number of employers are combining vacation days, sick days and personal days off work into a single category paid time off (PTO). PTO days are a single bank of days to use as they with for sickness, vacation or personal days. See “Paid Time Off Programs and Practices: A Survey of WorldatWork Members,” WorldatWork, May 2010. Available at http://www.worldatwork.org/adimLink?id=38913.

[7.] Jonathan Gruber, “The Incidence of Mandated Maternity Benefits,” *American Economic Review*, Vol. 84, No. 3, June 1994, pages 622-641. Available at http://tinyurl.com/pr4mlns.

[8.] “Employee Benefits in the United States –March 2014,” Bureau of Labor Statistics, New Release USDL-14-1348, July 25, 2014, Table 6. Available at http://www.bls.gov/news.release/pdf/ebs2.pdf.

[9.] For example, see Richard J. Butler, *The Economics of Social Insurance and Employee Benefits* (Mass.: Kluwer Academic Publishers, 1999).

[10.] For an explanation of the tax treatment of Health Savings Accounts under Internal Revenue Code Section 223, see “Internal Revenue Code § 223.” Available at http://tinyurl.com/kbqem4l.

[11.] Ashlea Ebeling, “What If You Use Your Health Savings Debit Card For Take-Out?” Forbes, Blog, February 1, 2013. Available at http://tinyurl.com/bkbbcrf.

[12.] Non-medical withdrawals are subject to ordinary income taxes. Thus, distributions are taxed at the marginal rate plus a 20 percent penalty. A worker with a marginal rate of 25 percent would suffer a 45 percent tax and penalty on nonqualifying HSA withdrawals.

[13.] Gary Claxton et al., “Employer Health Benefits 2014 Annual Survey,” Kaiser Family Foundation and Health Research & Educations Trust, 2014. Available at http://tinyurl.com/kpbkhz7.