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Can Tax Incentives Boost Workplace Emergency Savings?

Employer-sponsored emergency savings accounts (ESAs) are a unique opportunity to make a significant impact on employee financial wellbeing. To create lasting impact, broad adoption by employers and significant participation by employees is critical. Designing future legislation for employer-sponsored ESAs can and should include tax incentives for both the employers and employees.

In this report, Commonwealth reviews existing tax credits and incentives to increase participation in employer-sponsored benefits, and uncovers how these might be applied to emergency savings accounts (ESAs). We have identified both opportunities and challenges to the various types of incentives in the context of an ESA. Our goal is to provide guidance and considerations for future policy opportunities to increase employee participation and engagement with emergency savings.

Key Insights

We have identified opportunities and challenges to designing incentives for increasing both employer and employee participation:

- Allowing pre-tax contributions and tax-advantaged matches to a workplace ESA, is likely to be the most impactful, but also more complicated to pass and administer.
- A simpler tax incentive, such as considering a small seed deposit or other employer contribution to an ESA a de minimis benefit and not counted as taxable income, is more practically and politically feasible, but likely to have smaller impact.
- Tax credits delivered through the annual tax filing process for both employers and employees hold some promise, but raise important implementation questions around eligibility and credit amounts.
- Policymakers and other stakeholders will need to closely consider these trade-offs and any impact on the core features of a high-quality ESA.

We invite policymakers and other stakeholders to join us in further exploring these concepts and developing effective policies to incentivize workplace emergency savings.

Examining Tax Credits and Incentives to Increase Participation in Employer-Sponsored Emergency Savings Accounts

The COVID-19 pandemic, inflation, and other recent economic factors have highlighted the financial instability that many people living in the U.S. are facing today. A growing number of employers are recognizing the impact that this has on employee stress, productivity, and ability to save for retirement. A Mercer study has found that employee stress around finances can cost employers up to $250 billion in lost wages every year. This has led to more employers offering an emergency savings program as a workplace benefit.

For employer-sponsored ESAs to truly make an impact on employee financial wellbeing, broad adoption by employers and significant participation by employees is critical. Designing legislation for employer-sponsored ESAs can and should include tax incentives for both the employer to offer the program and the employee to participate. In fact, the SECURE 2.0 Act included a tax incentive for matching contributions to pension-linked emergency savings accounts (PLESAs).

While this is a promising policy approach to incentives, it will not benefit the nearly half of workers without access to a workplace retirement plan. We explore how this idea of an incentive for workplace emergency savings can be expanded upon by reviewing existing models for tax incentives for employer benefits such as healthcare, retirement savings, and health savings accounts, and will discuss how they might apply to emergency savings.

The Importance of Emergency Savings

A key aspect of financial resilience is the ability to cover unexpected expenses without going into debt or tapping into long-term savings. According to Federal Reserve research, 37% of people living in the U.S. do not have savings to cover a $400 unexpected expense such as a flat tire, emergency childcare needs, or medical fees. For people living in the U.S. with incomes less than $60,000 a year, that rate rises to 58%.

This results in many people turning to credit cards, loans, borrowing from friends and family, or taking hardship withdrawals from retirement savings to pay for emergency expenses. The resulting stress and potential accumulation of debt impacts the financial security of the individual or household, and can have negative consequences on overall health and family well-being. Additionally, a Mercer study shows that employee stress about personal finances can impact business outcomes, with an estimated $250 billion in lost productivity annually.

For households living paycheck to paycheck and struggling to pay for monthly expenses, saving for retirement may seem out of reach. As a result, many households earning low and moderate incomes (LMI) are not able to take advantage of the many tax incentives available for participating in retirement savings, or are being hit with penalties for early withdrawals. For this population, building short-term savings is a key stepping stone to financial stability and the ability to save for the future.

There is growing awareness among employers, recordkeepers, and policymakers around the need to support employees, particularly those living on LMI, in developing emergency savings. This is evident in the inclusion of two emergency savings provisions in the SECURE 2.0 Act of 2022 (see callout box) and the increase in employers considering emergency savings as a workplace benefit. According to a 2022 survey of employers by the Employee Benefit Research Institute (EBRI), 78% of employers consider emergency savings extremely or very important for future financial wellness initiatives. Large firms such as Starbucks, ADP, and Delta Airlines have all recently begun offering an ESA to their employees.

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SECURE 2.0 Emergency Savings Provisions

- Allows participants to withdraw up to $1,000 once a year from a retirement account for emergencies or immediate financial needs without any withdrawal penalties
- Employers can automatically opt employees into a pension-linked emergency savings account (PLESA) capped at $2,500
  - Employees who contribute to the PLESA are eligible for employer matching contributions to their retirement account

Criteria for Assessing Tax Incentives and Credits

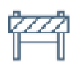
In assessing the applicability of different tax incentives and credits for ESAs, we considered various criteria, including impact on features of a high-quality emergency savings product, feasibility (both practical and political), and potential impact on ESA take-up and engagement. While this is not an exhaustive list of all tax incentives, we have reviewed the most common incentives for employer benefits and the most applicable to emergency savings accounts.

We focus on federal tax credits and incentives, as they are most widely accessible, though we acknowledge that pilots and innovation around tax credits and incentives can, and often do, happen at the state and local level. We also recognize there are other criteria that could be applied related to the fiscal impact of each of these incentives, but this would require more in-depth economic analysis and we believe these are an important baseline to begin the discussion.

Assessment Criteria

1. How the incentives might impact the features of a high-quality emergency savings product
2. Practical feasibility: implementation, administration, and access by workers earning LMI
3. Political feasibility: likelihood of passage through a legislative or policy process
4. Evidence of potential impact on participation and engagement with an ESA, particularly for workers earning LMI

WHAT MAKES A QUALITY EMERGENCY SAVINGS PRODUCT?



No Barriers to Entry

No Requisite Minimum Account Balance

Low or No Fees

No Restrictions (Especially Around Withdrawals and Usage)

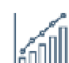
Liquid (Easy and Quick Withdrawal)

Transparency Around All Account Features

Active Marketing and Promotion

Portable (Between Employers or When Leaving the Workforce)

Principal-Protected



Auto-Enrollment with "Opt-Out" (Where Legal)

The Opportunities and Challenges of Different Types of Tax Credits and Incentives for Employer-Sponsored ESAs

ALLOWING FOR PRE-TAX CONTRIBUTIONS AND TAX-ADVANTAGED MATCHES TO ESAS WOULD LIKELY BE IMPACTFUL, BUT MAY BE DIFFICULT TO PASS AND ADMINISTER

The ability to contribute to a savings account pre-tax is one model of a tax incentive with the potential to boost employee participation. Contributions to these accounts lower an individual's taxable income and also allow for employers to contribute pre-tax match incentives. Retirement accounts such as 401(k)s and 403(b)s are among the most popular and accessible pre-tax savings benefits available to workers and include the added benefit of tax deductible employer matching contributions. According to the Bureau of Labor Statistics, 69% of private industry workers have access to their employer-based retirement plan, while around 52% of private industry workers chose to participate in their plan.

As noted above, the recently passed SECURE 2.0 Act allows employers to offer workplace ESAs linked to retirement plans and to provide pre-tax matching for employee contributions to these accounts. The tax-deferred employer contributions would be made to the employee's retirement account. However, this legislation does not apply to the millions of U.S. workers without access to retirement accounts through their employer, and does not extend the ability for employees to contribute pre-tax to emergency savings.

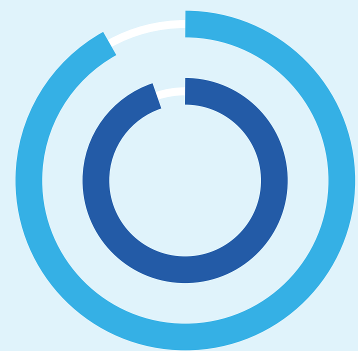
Other examples of accounts that allow for pre-tax contributions include Health Savings Accounts (HSAs) and Flexible Savings Accounts (FSAs) and are designed to reduce the financial burden employees face for covering medical expenses. An HSA tax-advantaged account may be used by participants of high-deductible health plans to pay for qualified medical expenses, while also helping to save for retirement and long-term care expenses. FSAs also allow for pre-tax contributions from the employee and/or employer, but unlike Health Savings Accounts (HSAs), Flexible Savings Accounts (FSAs) are not transferable and you must use your allocated funds by year's end or forfeit them.

Section 127 of the Internal Revenue Code is another model for a benefit that allows for tax-free employer contributions, in this case for qualified educational expenses. Section 127 allows for employers to contribute pre-tax for educational expenses such as tuition, books, and other equipment up to $5,250 per year. The CARES Act of 2020 extended allowable expenses under Section 127 to student loan repayment. The employer contributions to the qualified educational expenses do not constitute taxable income for the employee and are deductible expenses for the employer, creating tax savings for both parties. The employer must have a written educational assistance plan and provide reasonable notice to employees of the benefit.

Extending the ability to contribute pre-tax to ESAs, in addition to allowing for pre-tax employer match, has the potential to impact participation in emergency savings and help build financial resiliency for workers earning LMI. In a study in partnership with the Defined Contribution and Institutional Investment Association (DCIIA), Commonwealth found that 90% of research participants expressed interest in opening an ESA if an incentive from the employer were offered, with 96% preferring an employer match as the incentive. Given the popularity of and familiarity with the pre-tax contribution model for retirement accounts, educational assistance, HSAs, and FSAs, there is a relatively high practical feasibility of implementing this model for ESAs, depending on the specifics of the policy design. However, allowing for pre-tax contributions may not be a meaningful incentive for younger workers and those with more limited incomes who would have less tax liability.

Applying the pre-tax contribution model to ESAs may present challenges in terms of impact on the features of a quality ESA product and the political feasibility of implementing this type of tax incentive. Accounts that allow for pre-tax contributions typically carry very specific restrictions around usage and withdrawals, and a key feature of an ESA is liquidity. In researching workplace ESAs, AARP Public Policy Institute found that respondents were least willing to compromise on accessing their funds immediately. It would likely be challenging for policymakers to develop an agreed upon set of defined emergencies (which is typically how tax-preferred accounts allow withdrawals). There is precedent for this with accounts such as FSAs which have a broad list of approved medical expenses, including massages and sunscreen. However, these lists were not designed without controversy and some continue to advocate for allowing inclusion of payment for premiums, direct primary care, and fitness expenses, which are all currently not approved expenses.

It can also be difficult for employees to document an emergency expense that corresponds to the list of agreed upon emergencies, which could create a barrier to accessing funds and increase administrative burdens for processing withdrawals. Having a contribution limit or account cap could alleviate some of the concern around usage and the need to document an approved emergency expense in order to make a withdrawal. However, more evidence of the impact and use of ESAs by employees, including impact on retirement savings, may be needed for this to be politically feasible and to determine the appropriate amount for any contribution limit or account cap. PLESAs, allowed under the SECURE 2.0 Act, provide a clear opportunity to study ESA usage and the impact on retirement savings to inform this discussion, if and when they are implemented by employers and retirement plan providers.



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A PROMISING, THOUGH LIMITED, APPROACH OF ALLOWING "SEED FUNDING" OR SMALL EMPLOYER CONTRIBUTIONS FOR ESAS AS DE MINIMIS BENEFITS

De minimis fringe benefits are another model to explore for incentivizing participation in emergency savings. The IRS defines a de minimis benefit as "one for which, considering its value and the frequency with which it is provided, is so small as to make accounting for it unreasonable or impractical." A de minimis benefit does not qualify as taxable income for the employee. Examples of a de minimis benefit include snacks, entertainment/event tickets, holiday gifts, t-shirts, etc.

Previously, cash and cash equivalents such as gift cards would not qualify as a de minimis benefit and could not be provided as an incentive for participation in workplace retirement plan. However, the SECURE 2.0 Act now enables plan sponsors to boost employee participation in retirement savings accounts by providing immediate small-dollar financial incentives.

The new legislation allowing for small financial incentives to boost participation in retirement savings is a model that could be applied to emergency savings. In a recent survey that Commonwealth conducted in partnership with DCIIA, participants responded that small-dollar incentives ($10, $15, or $25) for enrolling in an ESA would increase their likelihood of enrollment in comparison to other solutions (such as a match to savings). It is also important to note that the IRS released guidance stating that a financial incentive qualifies as a de minimis benefit only if its value does not exceed $250. This suggests that a de minimis incentive could positively impact participation in an ESA, though the incentive would be relatively small, one-time, and would not reward ongoing savings behavior. It would provide another tool in the toolkit for employers to actively promote and market an ESA, which is a feature of a high-quality savings product.

Some employers offering an emergency savings benefit today provide this type of incentive through "seed deposits" or small monthly contributions to the employee's emergency savings account. However, these contributions qualify as taxable income, meaning the employee does not directly receive the full amount or the employer needs to "gross up" the incentive to account for tax withholdings. If this type of incentive could qualify as a tax-free de minimis benefit in the context of an ESA, it would alleviate some administrative burden for the employers as it would not require reporting as taxable income, and money that would otherwise go toward taxes could be put toward incentives. In order for this to be politically feasible, there would likely be a need for a clear definition of what value and frequency is considered "small." From our work with employers and ESA providers in piloting emergency savings solutions, Commonwealth has found that annual employer contributions to ESAs in the range of up to a few hundred dollars per employee has been effective in driving participation in the program.

EMPLOYER STARTUP CREDITS CAN SUPPORT SMALL BUSINESSES IN IMPLEMENTING OUT-OF-PLAN ESAS, BUT RAISE QUESTIONS OF ELIGIBILITY AND AMOUNT

We will next examine tax incentives for employers to begin offering a benefit. These incentives generally apply specifically to small businesses that would otherwise struggle to afford the administrative costs associated with offering certain benefits. For example, small businesses are eligible for a federal healthcare tax credit of up to 50% of their healthcare premiums for two consecutive years. Another example also comes through the SECURE 2.0 Act in a provision providing small businesses 50% of the cost to start offering a company-wide retirement plan.

A similar incentive could be provided for businesses to offer an ESA by covering some or all of the startup costs. This would be particularly beneficial for small businesses with high percentages of employees earning LMI in industries such as restaurants and retail, which often struggle to provide holistic workplace health and financial wellness benefits due to the cost of administration. This type of incentive could relieve some of the burden for small businesses to offer an emergency savings benefit, but would not provide an incentive to the employee for participating. In other words, this incentive could increase the availability of ESAs and make it easier for employees to participate, but not necessarily boost participation in the benefit through any direct incentive to the employee. Increased access to ESA, particularly for workers with less access to workplace benefits (e.g., employees at small businesses) would still be an important step.

To be politically feasible, the credit would likely need to be restricted to small businesses, as there is a bipartisan recognition that small businesses experience greater challenges to offering workplace benefits. Additionally, the incentive would likely need to be limited in both amount and duration, such as covering startup costs for the first few years. Identifying an amount that is both politically feasible and meaningfully reduces the cost burden on small employers would require additional research on the typical costs of implementation for this relatively new benefit, as well as an assessment of the likelihood of adoption by small employers.

Furthermore, this tax credit would likely be best suited for employers who opt for a solution outside of their retirement plans, as startup costs for an in-plan ESA solution would be built into the overall cost of the retirement plan, making it difficult to document as separate costs for the ESA only. This could incentivize small businesses to choose an out-of-plan ESA, though building upon the SECURE 2.0 retirement plan startup incentive to allow for an additional credit for employers who include an in-plan ESA could create parity. Finally, a time-limited benefit would mean that employers would be required to cover any ongoing administrative costs which may threaten the sustainability of the benefit.

A TAX CREDIT FOR EMPLOYEES SAVING TO AN ESA COULD BUILD ON EXISTING CREDITS, BUT MAY BE CHALLENGING TO IMPLEMENT POLITICALLY AND PRACTICALLY

The final example of a tax incentive for employee benefits that we examined is a tax credit that is delivered directly to the taxpayer when they file their taxes. Examples of this include the Earned Income Tax Credit (EITC), which provides a tax credit to low-wage employees for the income that they earn, and the Saver's Credit, which is a tax credit of up to 50% of an eligible employee's contributions to retirement savings for the year.

A benefit similar to the Saver's Credit could be designed for emergency savings contributions. Following this model, the employee would receive a credit when they file their taxes based on the amount they contributed to an emergency savings account. There are some practical challenges in applying this type of credit to emergency savings. One is deciding how "savings" is defined in this context of an ESA. Liquidity is an important feature of a quality emergency savings product, so an employee may contribute with every paycheck but then utilize the money when needed for an emergency expense. A credit based on balances in the account would effectively penalize individuals withdrawing from the account, which is one of its intended uses. A credit based on contributions may raise concerns about "gaming" the credit, in which an employee contributes and immediately withdraws funds simply to qualify for the credit. Restrictions on usage would be one way to mitigate this concern, but would impact liquidity and create a new set of administrative burdens.

A second practical challenge is defining what type of account qualifies as an emergency savings account, as there are several models of ESAs in market, including those offered by traditional financial institutions, fintechs, retirement plan providers, and payroll firms. It may be practically and politically challenging to agree on a definition of ESA for the purposes of a credit. The timing of the credit delivered as part of tax time may limit impact on employee participation. Employees may not know they are eligible for the credit at the time they are offered the opportunity to participate in the ESA, nor the potential value of the credit, which creates a communication challenge. The credit could be delivered as an advanced credit based on estimated eligibility; however, that creates additional administrative challenges such as reporting income or household changes that affect credit eligibility, setting rules for recapture at tax filing time, and refundability. Finally, this type of credit only applies to the participating employees who meet some eligibility criteria and would not provide any incentive to employers to offer the benefit, which is a critical step to ensuring employee access to ESAs.

The Kansas State legislature attempted to create a legislative solution to allow for tax credits for both the employer and employee for contributions to an approved ESA. The Kansas State Employee Emergency Savings Program (KEESA) bill was introduced in 2022 and would have allowed for automatic payroll deductions into an ESA, with an initial seed deposit from employers of $50. The bill was designed to provide tax credits for a percentage of employer seed deposits and match contributions up to $325 per employee, as well as tax credits to the employee for a percentage of contributions up to $1,500. The program would have only been available to small businesses of less than 250 employees. Although this bill died in committee in May 2022 after review by the Commerce, Labor, and Economic Development Committee, it can serve as a valuable example to study and further understand the political and practical reasons that it did not move forward, including the decrease in state revenue and cost to implement.

Impact and Feasibility of Incentives

The table below offers a high-level comparison of the various types of tax incentives for employer-sponsored benefits. Here we assess the political and practical feasibility, the impact on a high-quality emergency savings product, and the likelihood of participation by employees earning LMI.

Type of Incentive	Impact on High-Quality ESA Product	Practical Feasibility	Political Feasability	Likelihood of Impact on Participation by Employees Earning LMI
Pre-tax contributions to an account	Would likely require withdrawal and usage restrictions, limiting liquidity If tied to a retirement plan, may limit portability	Other tax-advantaged savings accounts can serve as a model Withdrawal and usage restrictions would create administrative burden that may be a barrier to implementation	Would likely require agreement on a defined set of emergency expenses and/or account cap and withdrawal limitations More evidence of impact of ESAs needed for policymaker buy-in to lessen restrictions	Liquidity is the most important feature of ESA for employees earning LMI so account restrictions would likely impact participation Without restrictions, pre-tax contributions and employer match have been shown to be strong incentives for participation in general; for employees with low/ no tax liability, this may be less motivating
De Minimis Benefits	Likely no negative impact Positive impact on employer ability to market and promote ESA with an initial incentive	Depending on the type of benefit, this would likely require minimal administrative work Small "seed deposits" are already being built into many ESA offerings	De minimis benefits as an incentive for participation in retirement accounts was recently allowed through legislation; however, that benefit is taxable as income Would likely require agreement on more specific definitions for "small and infrequent"	Small-dollar incentives can be a strong motivator for employees earning LMI Unclear how an initial incentive may impact ongoing savings behavior Minimal incentive for the employer may not lead to increase in availability of ESA offerings
Employer Tax Credits for Offering a Benefit	May require restrictions around the type of accounts and costs which could impact quality of ESA product	Employers familiar with this type of tax credit (healthcare, retirement)	Precedent for this type of incentive, though, generally limited to small businesses and only for the first few years Decisions around the amount and duration of the credit and what businesses qualify would be necessary	Would likely only apply to small businesses for the first few years which limits scale and sustainability No direct benefit to the employee
Individual Tax Credits for Saving	Likely requires withdrawal and usage restrictions May also require a specific type of ESA, which could impact other features	Burden of claiming credit is on the employee, which would require significant promotion to build awareness of new credit	Difficult to define "savings" in liquid accounts and what qualifies for the credit (e.g., contributions vs. balances) Would require agreement on what qualifies as an ESA	Timing of an incentive delivered at tax time may limit impact, due to lack of awareness of eligibility Restrictions could lead to confusion on eligibility and impact liquidity of accounts

Conclusion and Recommendations

In exploring various models of existing tax-advantaged employer-sponsored benefits and how they might be applied in the context of an ESA, we have identified both opportunities and challenges to designing incentives for increasing both employer and employee participation.

- An ESA that allows for pre-tax contributions by employees and tax-advantaged matching by employers, such as a 401(k), educational assistance programs, HSAs, and FSAs, is a familiar model to employees and employers, benefits both parties, and provides a clear incentive for ongoing engagement. However, this approach would likely require restrictions around usage and barriers to entry that could compromise the quality and efficacy of the ESA.
- A tax credit for employers to cover the startup costs for an ESA would likely make this offering more accessible to businesses and employees, but would likely be limited in impact and scale by only applying to small businesses for the first few years of the offering. It would also fail to provide an incentive directly to the employee for participating.
- An employee tax credit for emergency savings, similar to the Saver's Credit for retirement contributions, would provide an incentive directly to the employee, but questions remain regarding defining "savings" in the context of a liquid account, what type of account qualifies, and how to ensure employees are aware of and take advantage of a credit that would be delivered long after they start saving.
- Allowing for de minimis benefits that are tax-exempt to be provided as an incentive for participation in ESAs seems to have the highest level of practical and political feasibility, given its simplicity. It could alleviate some administrative burden and save employers money to be put toward the incentive. Our research has shown that these small dollar incentives, such as a "seed deposit" to an account and/or a small monthly employer contribution can be a strong motivator for employees to participate. This type of tax incentive would likely have little to no impact on the quality of the ESA product. However, it is limited in its benefits to both employers and employees, and the scale of impact on access and ongoing saving engagement is unclear.

Each of the models for tax incentives explored in this piece could be applied to employer sponsored ESAs and merit additional consideration by policymakers. However, the nature of a liquid, short-term savings account creates complexities in political viability and practical implementation when compared to other, more restricted workplace savings programs.

As employer-sponsored ESAs continue to grow as a workplace benefit, employers, workplace benefit providers, policymakers, and other stakeholders will need to be creative in considering how to design incentives that ensure ESAs are widely accessible and reach all employees, especially those earning low and moderate incomes. Otherwise, we collectively run the risk that the benefits of ESAs accrue to those who are already more financially secure.

We invite policymakers and other stakeholders to work with us to design innovative policy approaches to incentivize participation in ESAs. Contact us at info@buildcommonwealth.org to start the conversation.

Check out our website to learn more about Commonwealth's work in emergency savings.

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Commonwealth is a national nonprofit building financial security and opportunity for financially vulnerable people through innovation and partnerships. Black, Latinx, and women-led households disproportionately experience financial insecurity due in large part to longstanding, systemic racism and gender discrimination. Addressing these issues is critical to Commonwealth's work of making wealth possible for all. For nearly two decades, Commonwealth has designed effective innovations, products, and policies enabling over 2 million people to save nearly $8 billion in savings. Commonwealth understands that broad changes require market players to act. That's why we collaborate with consumers, the financial services industry, employers, policymakers, and mission-driven organizations. The solutions we build are grounded in real life, based on our deep understanding of people who are financially vulnerable and how businesses can best serve them. To learn more, visit us at www.buildcommonwealth.org.

BlackRock announced a $50 million philanthropic commitment to help millions of people living on low to moderate incomes gain access to and increase usage of proven savings strategies and tools – ultimately helping them establish an important safety net. The size and scale of the savings problem requires the knowledge and expertise of established industry experts that are recognized leaders in savings research and interventions on an individual and corporate level. Led by its Social Impact team, BlackRock is partnering with innovative industry experts Common Cents Lab, Commonwealth, and the Financial Health Network to give the initiative a comprehensive and multilayered approach to address the savings crisis. Learn more at www.savingsproject.org.

The W.K. Kellogg Foundation (WKKF), founded in 1930 as an independent, private foundation by breakfast cereal innovator and entrepreneur Will Keith Kellogg, is among the largest philanthropic foundations in the United States. Guided by the belief that all children should have an equal opportunity to thrive, WKKF works with communities to create conditions for vulnerable children so they can realize their full potential in school, work and life.