



# Flexible and Portable Benefits for Independent Workers: Federal Policy Guide

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Today more than one-third of Americans earn income through independent contracting, freelancing, or gig (temporary and on-demand) work.<sup>1</sup> For some, independent work provides supplemental income to help meet financial needs, while for others, it provides the only opportunity to enter the workforce. Independent workers are diverse, spanning a wide range of industries, skill levels, and educational backgrounds. They include freelance creatives, knowledge-work professionals, contractors, self-employed service providers, merchants or sellers, and entrepreneurs.

The growth of this nontraditional workforce presents policy challenges because many independent workers lack access to standard employment-based benefits such as health insurance and retirement savings plans. Policymakers and regulators are debating how to best address the issue. Some federal and state proposals aim to reclassify workers as employees, such as the Department of Labor’s most recent independent contractor rule and California’s Assembly Bill 5. Far from delivering their intended results, these reclassification policies tend to harm the independent workforce,<sup>2</sup> the vast majority of which prefers to keep nontraditional work arrangements rather than be forced to switch to traditional employment.<sup>3</sup>

Most independent workers would gain from and value flexible or portable benefits—benefits that are not tied to a particular job or employer but travel with the worker. States are already beginning to experiment with various portable benefits models.<sup>4</sup> In this policy brief, we outline seven comprehensive federal reforms that support flexible and portable benefits for independent workers.

The following seven key federal policy recommendations are designed to increase the provision of benefits to independent workers:

1. Stipulate that no federal agency can use the presence of benefits to determine whether a worker is an independent contractor or an employee.

2. Allow independent workers to register as such, and ensure that federal regulators treat registered independent workers accordingly.
3. Expand the tax advantages of Section 125 cafeteria plans to independent workers by creating flexible benefits accounts.
4. Create tax-advantaged universal savings accounts (USAs) to enable flexible savings options for independent workers.
5. Reform association health plans (AHPs) to allow all self-employed workers to join together under a broadly defined “commonality of interest” for the purpose of buying health insurance.
6. Improve individual coverage health reimbursement arrangements (ICHRAs) to allow self-employed workers to use pretax dollars to purchase health insurance on the individual market.
7. Relax restrictions on health savings accounts (HSAs) to enable greater participation by self-employed workers.

## **REMOVING BARRIERS TO BENEFITS FOR INDEPENDENT WORKERS**

### **Recommendation 1: Stipulate that no federal agency can use the presence of benefits to determine whether a worker is an independent contractor or an employee.**

The current regulatory framework restricts and thus discourages organizations from providing benefits to independent contractors. Despite state efforts to support portable benefits through reforms, federal agencies such as the Department of Labor (DOL) and the Internal Revenue Service (IRS) include the presence of benefits in the worker classification test. Thus, when a company provides benefits other than compensation to an independent contractor, there is a risk that the worker will be reclassified as an employee, which would result in the company incurring higher costs and misclassification fees or penalties. Additionally, the company and the worker would face steep hurdles to keep the relationship contractual, as desired. This leaves no option for workers to maintain independence and to access benefits through a contracting company.

Federal policy can legalize access to benefits for independent contractors by explicitly stating that no federal agency can use the presence of benefits to determine whether a worker is an independent contractor or employee. Federal policy must also explicitly state that if a hiring party provides benefits subject to the Employee Retirement Income Security Act (ERISA) to an independent worker, that does not initiate an employee–employer relationship. Removing the presence of benefits from worker classification tests would allow companies to voluntarily offer independent workers a “menu” of benefits depending on the companies’ resources, thus improving benefit accessibility for independent workers.<sup>5</sup>

**Recommendation 2: Allow independent workers to register as such, and ensure that federal regulators treat registered independent workers accordingly.**

Many businesses that contract with legitimate independent workers are concerned that regulators might misconstrue the nature of their business relationship. If the National Labor Relations Board (NLRB), the Department of Labor, or the Internal Revenue Service reach the conclusion that an independent contractor has been “misclassified,” the contracting business could face expensive penalties and legal action. To avoid such a scenario, the federal government should offer workers the option to formally register their independent status with a federal agency. Proof of registration would provide businesses with confidence that federal investigations will confirm the workers’ independent classification. With this assurance, hiring parties will be more inclined to provide benefits to independent workers without fearing repercussions.

Workers who have an LLC (and thereby are registered as an official business entity) should be automatically eligible to obtain this optional self-certification. Workers who have not registered as an LLC should be permitted to obtain this self-certification as long as they meet one of the following criteria: have a household income greater than the poverty threshold, are under the age of 26, or are eligible for social security. These criteria help protect vulnerable members of the population.

Optional self-certification would not interfere with a federal agency’s existing worker classification test but would be recognized by all federal agencies as stating the worker’s intent to be independent. Businesses would still be required to comply with each federal agency’s worker classification determinations. The optional self-certification process would serve as an additional measure that independent workers could undertake to provide assurance of their status.

## **CREATING OPPORTUNITIES FOR FLEXIBLE BENEFITS AND SAVINGS**

**Recommendation 3: Expand the tax advantages of Section 125 cafeteria plans to independent workers by creating flexible benefits accounts.**

Section 125 cafeteria plans are employer-sponsored benefits plans that allow employees and employers to make pretax contributions to a variety of employee benefits. Therefore, company contributions and employee contributions are shielded from an employee’s payroll and federal income taxes. These contributions can be used to pay health insurance premiums, purchase disability insurance, pay for parking, or be deposited into retirement, health, or flexible savings accounts. This tax advantage does not currently exist for self-employed workers.<sup>6</sup>

Through a nationwide survey, Massachusetts Institute of Technology economist Jonathan Gruber found that Uber drivers highly valued these types of flexible benefits accounts.<sup>7</sup> To this end, policymakers could allow independent workers to create a cafeteria plan similar to what employees are able to do under Section 125 of the tax code. In such a scenario, the independent workers would contribute pretax income to their flexible benefits account, which could be used to make

purchases that are eligible in a Section 125 cafeteria plan (such as retirement savings, life and disability insurance, dependent care expenses).

Additionally, organizations that contract with a worker could contribute to the independent workers' flexible benefits account in a pretax manner, similar to how employers contribute to employee benefit plans without it being considered taxable income for the employee. It should be clarified that contributions from hiring parties to flexible benefits accounts can not be used as a factor in determining a worker's classification status

Creating Section 125-like flexible benefits accounts for independent workers would equalize tax treatment for all types of workers and provide a fundamental vehicle for benefits to independent workers.

#### **Recommendation 4: Create tax-advantaged universal savings accounts (USAs) to enable flexible savings options for independent workers.**

Independent workers have limited access to employer-sponsored retirement benefits and traditional savings platforms. Current retirement vehicles—such as 401(k)s and IRAs—are poorly suited for the diverse needs of independent workers, and many independent workers are discouraged from using them, fearing the complex penalties for misusing funds.

Universal savings accounts would offer a more flexible, clear, and nondistortionary solution for independent workers to save for their own priorities.<sup>8</sup> The key advantage of USAs would be that, unlike traditional retirement accounts, they would allow tax-free withdrawals at any time for any purpose without penalties or usage restrictions. USAs therefore would encourage greater savings while also offering the freedom to withdraw those savings as needed, before or after retirement.

While USAs would benefit all workers, they would be especially valuable to independent workers for the following reasons:

- The accounts would not be tied to one specific employer, and therefore would suit independent contractors who often work with many different clients and companies at a time.
- Independent workers often face income instability and may need access to savings during periods of low income. Existing retirement accounts penalize early withdrawals before retirement age. USAs would allow penalty-free withdrawals, which would make them attractive to those whose income fluctuates.
- USAs would be flexible; the funds could be used for paid time off, health insurance premiums, or other needs depending on the individual worker.

## **IMPROVING ACCESS TO HEALTHCARE BENEFITS**

Health insurance coverage is often a significant concern for independent contractors. While some contractors are able to access health insurance through a full-time job, a spouse's plan, or a government program, others are not so fortunate.<sup>9</sup> Self-employed workers are more likely to be uninsured compared to employees of companies. Reforms should aim to remedy this critical issue by making healthcare benefits more accessible and affordable for independent workers.

### **Recommendation 5: Reform association health plans (AHPs) to allow all self-employed workers to join together under a broadly defined “commonality of interest” for the purpose of buying health insurance.**

Self-employed workers typically pay higher individual insurance premiums because they lack access to group rates through an employer. Allowing self-employed workers to form groups to purchase health insurance collectively also allows them to benefit from reduced premiums.

In 2018, the DOL issued a regulatory change that expanded the definition of “employer” so that self-employed individuals, independent contractors, freelancers, and gig workers could access AHPs. The DOL stated that “Association Health Plans work by allowing small businesses, including self-employed workers, to band together by geography or industry to obtain healthcare coverage as if they were a single large employer.”<sup>10</sup> However, a federal court voided this rule after years of legal challenges, so reform in this area would likely need to come from Congress, rather than as a regulatory rule change from federal agencies.

Congressional policymakers would need to pass a legislative reform that allows self-employed individuals, independent contractors, freelancers, and gig workers to form such associations and offer AHPs to the members of such organizations.

### **Recommendation 6: Improve individual coverage health reimbursement arrangements (ICHRA) to allow self-employed workers to use pretax dollars to purchase health insurance on the individual market.**

ICHRA are a type of health benefit plan that allows employers to reimburse employees for medical expenses on a tax-free basis. These expenses can include premiums for individual health insurance policies. ICHRA offer a flexible alternative to traditional group health insurance plans by providing employees with more choices in selecting health insurance that best fits their needs. Currently, ICHRA offer 11 classes, which separate employees according to job-based criteria such as number of hours worked (part-time or full-time) and location. None of these 11 classes include self-employed workers.

The simplest way for federal policymakers to expand ICHRA to self-employed workers is by allowing for an additional 12th class dedicated to self-employed workers. This can be achieved by

amending the Internal Revenue Code and ERISA to create a new class that includes self-employed individuals as eligible participants in ICHRAs. Below are two additional reforms that can support access to ICHRAs by self-employed workers:<sup>11</sup>

- a. Amend the tax codes to allow self-employed individuals to receive and deduct contributions to ICHRAs in the same manner as traditional employees do. This would require modifying sections of the Internal Revenue Code that pertain to health reimbursement arrangements.
- b. Expand what counts as a self-employed health insurance deduction to include contributions to ICHRAs. Currently, self-employed individuals can deduct their health insurance premiums from their income taxes, but this deduction does not apply to self-employment taxes (which are the equivalent of payroll taxes for employees). As a result, self-employed workers end up paying a 15.3 percent tax on money used for health insurance, while their employed counterparts do not pay income or payroll taxes on money used for the same expenses. The regulations should be updated to allow ICHRA contributions to be deductible from both income and self-employment taxes.

### **Recommendation 7: Relax restrictions on health savings accounts (HSAs) to enable greater participation by self-employed workers.**

The following are recommendations from the Paragon Health Institute for how to create more flexible HSAs for self-employed workers:<sup>12</sup>

- a. Currently, patients may only contribute to an HSA if they have a high-deductible health plan (HDHP). But some insurance plans with lower deductibles still require significant cost sharing for the patient, making an HSA a valuable incentive to being a better health-care consumer. Basing HSA eligibility on the actuarial value of the total cost sharing across likely patient spending would allow health plans with different deductibles and benefit structures to qualify as HSA compatible. This would particularly benefit self-employed workers who might prefer plans with different cost-sharing structures. Moreover, allowing catastrophic, bronze (60 percent actuarial value), and silver (70 percent actuarial value) plans to be HSA-eligible would provide more options for self-employed individuals. These plans typically have lower premiums and can be more affordable while still allowing for the benefits of HSA contributions.
- b. Currently, HSA funds cannot be used to pay health insurance premiums except under specific conditions like unemployment. Allowing premium payments under a wider range of conditions would provide significant financial relief to self-employed individuals who are not covered by an employer-sponsored health insurance plan.
- c. Raising the contribution limits for HSAs would allow self-employed individuals to save more pretax dollars for medical expenses and health insurance premiums.

- d. Ensuring that HSA contributions can reduce both income- and self-employment taxes would align the tax benefits of HSA contributions with the tax treatment that traditionally employed workers receive, making it more equitable for self-employed individuals.

As discussed earlier, it should be clarified and stipulated that if hiring parties provide benefits to independent contractors (for example, by making contributions to their HSAs), these benefits cannot be used as a factor in determining worker classification.

## CONCLUSION

For many Americans, independent work is beneficial, desirable, and even preferred. Policymakers should embrace the new reality of US labor and aim to fix the hardships that independent workers face. Unfortunately many Americans who choose independent work do not have access to the same benefits afforded to traditional employees. Federal policymakers can address this and better meet the needs of the growing independent workforce by making reforms in line with this report. Embracing these innovative policy reforms will create a fairer system for all workers, enhancing the livelihoods of independent contractors without harming existing employees.

## APPENDIX

### **FAQs: Flexible and Portable Benefits for Independent Workers, Federal Policy Guide**

1. Do flexible and portable benefits reforms increase the chances of misclassification?

No, they will decrease the chances that a worker who intends to be treated as an independent contractor will be improperly labeled as an employee by a federal agency. Even with flexible benefits, businesses are still required to classify workers based on the laws enforced by each agency. This means that if regulators find that a business is misclassifying independent contractors as employees, that business is in violation of federal laws. The proposed portable benefits reforms should have no impact on that determination. Merely offering funds to workers that they can use to purchase portable benefits should not determine whether a worker is an employee or not. Legalizing access to benefits for independent contractors means that legitimate and properly classified independent contractors will be able to receive benefits from hiring parties.

2. Does federal self-certification amend existing worker classification tests?

No, the optional self-certification does not alter a federal agency's worker classification test. Rather, it demonstrates the worker's intent to be treated as an independent contractor. Businesses are still required to properly classify workers as either employees or independent contractors according to federal law. This optional self-certification allows independent workers to indicate their belief that they would be deemed independent by federal agencies' existing worker classification tests. The self-certification is meant to give safe harbor to those who hire



independent workers and help protect legitimate, properly classified independent workers by allowing them to register with a federal agency as an independent business entity.

3. What criteria should be used to obtain state self-certification as an independent worker?

Workers who have a Limited Liability Company (LLC), and are thereby registered as an official business entity, would be eligible to obtain this optional self-certification. Workers without an LLC could also obtain this self-certification if they plan to act as an independent contractor and as long as they (1) have a household income greater than the poverty threshold, (2) are under the age of 26, or (3) are eligible for social security. These additional criteria would help protect vulnerable members of the population.

4. What is the difference between typical retirement savings accounts and universal savings accounts (USAs)?

The key advantage of USAs is that unlike existing types of retirement accounts, USAs allow tax-free withdrawals at any time for any purpose without penalties and have no restrictions on how the savings are used, whether for retirement, paid time off, emergencies, a new business, or something else.

5. Do organizations receive tax-savings benefits if they provide contributions to an independent worker's Section 125 flexible benefits account?

Organizations do not receive any special tax-saving benefits for making contributions to an independent worker's Section 125 cafeteria plan account. These costs would be treated as ordinary business expenses for tax purposes. Only independent workers will realize tax benefits because contributions to an independent worker's flexible benefits account will be shielded from that worker's federal income and self-employment taxes—similar to how an employee's contributions to benefits accounts are shielded from that employee's federal income and payroll taxes.

## ABOUT THE AUTHORS

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## NOTES

1. About 10 to 29 percent of US workers engage in independent work as their primary source of income, and up to 39 percent use it as a supplementary source of income. To get a better sense of this range, see table 1 in Liya Palagashvili, *Understanding Nontraditional Work Arrangements and the Policy Landscape for Self-Employed and Gig Workers* (American Enterprise Institute, July 3, 2023).
2. Liya Palagashvili et al., “Assessing the Impact of Worker Reclassification: Employment Outcomes Post-California AB5,” (Mercatus Working Paper, Mercatus Center at George Mason University, January 31, 2024).
3. Bureau of Labor Statistics, “Contingent and Alternative Employment Arrangements—May 2017” (news release no. USDL-18-0942, June 7, 2018).
4. Liya Palagashvili, “Flexible Benefits for a Flexible Workforce: Legalizing Access to Portable Benefits for Independent Workers” (Testimony before the House Subcommittee on Workforce Protections, Mercatus Center at George Mason University, April 11, 2024).
5. Liya Palagashvili, “Flexible Benefits for a Flexible Workforce: Unleashing Portable Benefits Solutions for Independent Workers and the Gig Economy,” (Mercatus Policy Brief, Mercatus Center at George Mason University, February 3, 2023).
6. Self-employed workers can contribute to a tax-deferred retirement account and can deduct health insurance premiums from their federal income tax obligations, but not from their self-employment taxes (equivalent to payroll taxes for employees).
7. Jonathan Gruber, “Designing Benefits for Platform Workers” (NBER Working Paper No. 29746, National Bureau of Economic Research, February 2022).
8. Adam N. Michel, “Universal Savings Accounts: A Flexible Financial Tool to Support the Gig Economy,” (Policy Paper 2020.007, Center for Growth and Opportunity, July 2020).
9. For example, Jonathan Gruber’s survey found that 77 percent of Uber drivers have health insurance (compared to 89 percent for workers nationally), and among that group, 52 percent receive their insurance either through their primary employer or through a family member’s employer. See Gruber, “Designing Benefits for Platform Workers.”
10. Department of Labor, Employee Benefits Security Administration, Definition of “Employer” Under Section 3(5) of ERISA—Association Health Plans, 29 C.F.R. Part 2510 (2018), <https://www.govinfo.gov/content/pkg/FR-2018-06-21/pdf/2018-12992.pdf>.
11. These recommendations come from Theo Merkel and Brian Blase, “Follow the Money: How Tax Policy Shapes Health Care” (Paragon Health Institute, May 2024).
12. Merkel and Blase, “Follow the Money.”