BENEFIT Plan Developments

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Federal Rule Allows Employers To Cut Health Care Benefits For Older Retirees

The U.S. Equal Opportunity Commission (EEOC) issued a final rule on December 26, 2007 that would allow employers to continue what it calls the longstanding and common practice of providing more generous health care benefits to younger retirees than to retirees 65 and older who qualify for Medicare, without violating the Age Discrimination in Employment Act (ADEA).

The ruling is intended to settle a dispute that arose following a decision handed down in 2000 by the U.S. Court of Appeals for the Third Circuit in the case of Erie County Retirees Association v. County of Erie. The court held at that time that, under the ADEA, employers are required to provide the same health insurance benefits to all retirees, regardless of whether they are eligible to receive Medicare benefits.

Opponents of the Erie County decision have argued that, if enforced, many employers would stop offering retiree health care benefits altogether, leaving many retirees under the age of 65 who currently receive employer-provided benefits uninsured. Currently, employers that provide retiree health care benefits usually coordinate their coverage with Medicare benefits, often by "bridging" the period between retirement and age 65, when retirees become eligible for Medicare, and then scaling back or eliminating these benefits for older retirees. Under the new EEOC regulation, employers would be permitted to continue to offer differing levels of health care benefits depending upon the retiree's age.

"Implementation of this rule is welcome news for America's retirees, whether young or old," said commission chair Naomi C. Earp. "By this action, the EEOC seeks to preserve and protect employer-provided retiree health benefits which are increasingly less available and less generous.

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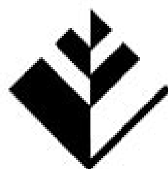

BenefitsInc

9301 Southwest Freeway, Suite 270
Houston, TX 77074
Phone: (713) 772-1700 • Fax: (713) 772-3100

Millions of retirees rely on their former employer to provide health benefits, and this rule will help employers continue to voluntarily provide and maintain these critically important benefits in accordance with the law."

According to the EEOC, the new regulation has the support of key members of Congress, as well as of influential employer and labor organizations, including the AFL-CIO, the Society for Human Resource Management (SHRM), the National Education Association (NEA), and the American Benefits Council.

The EEOC had previously attempted to establish a rule explicitly exempting retiree health benefits from ADEA coverage, but it was blocked by a lawsuit filed by AARP, an advocacy group for people over the age of 50. Yet, in June 2007, the U.S. Court of Appeals for the Third Circuit in Philadelphia upheld the EEOC's claim that it was in the public interest to exempt retirement health benefits from age discrimination laws. AARP has asked the U.S. Supreme Court to review the decision.

AARP Legislative Policy Director David Certner condemned the new EEOC ruling, calling it "a civil rights and economic fiasco," and "a wrong-headed move to legalize discrimination, allowing employers to back off their health care commitments based on nothing more than age."

Claiming that the issue is about more than just age discrimination, Certner said, "The costs of health care are skyrocketing for everyone, from the corporate board room to the kitchen table. By transferring health care costs, the EEOC merely passes the buck to those who can little afford it."

However, EEOC legal counsel Reed Russell pointed out that the rule makes clear that it is lawful for employers to continue to provide retirees with the health benefits they currently receive. "Contrary to what some interest groups have erroneously asserted, the rule will not require any cuts to retiree benefits," Russell said.

Because Section 125 benefits are not subject to FICA or income taxes, cafeteria plans can help employees lower their taxable income, while reducing the payroll and workers compensation tax liabilities of their employers.

Cafeteria Plans Provide Tax Savings And Flexibility

Section 125 "cafeteria plans" can help business owners and employees alike trim considerable sums from their tax bills. Under Section 125 of the Internal Revenue Code, workers are permitted to withhold a portion of their pre-tax salaries to pay for premium contributions to employer-sponsored insurance plans and to cover qualifying unreimbursed medical and dependent care expenses. Because Section 125 benefits are not subject to FICA or income taxes, cafeteria plans can help employees lower their taxable income, while reducing the payroll and workers compensation tax liabilities of their employers.

As the name suggests, employees who participate in a cafeteria plan are invited to choose from a menu of employer-sponsored benefits. In some cases, both the employer and the participating employees share in benefit costs. The company's contribution may consist of an annual benefits allowance that employees can use to pay for benefits or take as salary.

The most basic cafeteria plan feature is the premium only plan (POP). Also known as premium conversion plans, POPs allow employees to withhold part of their pre-tax salary to fund their premium contributions to employer-sponsored insurance plans, including medical, dental, disability, accident, and group term life insurance. A POP is easy to set up and administer, and it does not require the employer to offer any new benefits.

A cafeteria plan may also include a flexible spending account (FSA) feature, which provides employees with the opportunity to pay for dependent care and/or unreimbursed medical expenses using pre-tax dollars. To take advantage of the FSA option, an employee must estimate before the start of each tax year how much he or she will spend on medical or dependent care expenses, and commit to

having a set amount withheld from each pay period to help cover these expenses. The agreed-upon sum is deducted from the employee's paycheck before taxation and deposited in the individual's FSA. Employees pay for qualifying expenses out-of-pocket and submit a claim to the plan administrator for reimbursement. Unless an unanticipated change in family status occurs, employees are not permitted to change or cancel a Section 125 agreement during the tax year.

While nearly all taxpayers incur some health care costs that are not covered by insurance, most find that their unreimbursed medical expenses do not exceed the 7.5% of adjusted income floor that would allow them to qualify for a federal income tax deduction. But, by contributing to a medical FSA, employees get a tax break on these miscellaneous health care and dental expenses, which may include deductibles and co-payments, prescriptions, over-the-counter drugs, and orthodontia. The maximum amount that may be contributed to a medical FSA is $5,000 a year.

The dependent care FSA allows employees who pay for childcare or eldercare services to save money up-front, rather than waiting to claim a deduction or credit on their tax returns. Heads of household and married couples are permitted to withhold up to $5,000 annually of their pre-tax earnings to pay for dependent care services that enable them to work, look for work, or attend school full time. Qualified dependent care expenses generally include care for a child under the age of 13, as well as in-home or daycare services for a spouse or adult dependent incapable of self-care. Individual employees should, however, calculate whether they and their families would save more by paying for dependent care expenses through an FSA or by claiming the child and dependent care tax credit.

The biggest drawback associated with FSAs is the "use-it-or-lose-it" deadline imposed by the IRS. This rule stipulates that employees forfeit any funds left in their individual FSAs at the end of the year. The remaining balance is retained by the employer to offset administrative costs and to help pay for future benefits. This rule was modified in 2005 to permit cafeteria plan sponsors to extend the deadline for using the funds for up to 2½ months after the end of the year. There is also a grace period of 90 to 120 days during which employees may submit claims for expenses incurred during the coverage period.

Most business owners find that Section 125 cafeteria plans are simple to set up and administer. The tax savings offered by these plans can also cushion the effects of rising insurance premiums on employers and employees. And, because cafeteria plans encourage workers to take an active role in selecting and managing their benefits, companies can use these plans to increase awareness among workers of the value of their employer-provided benefits.

401(k) Reform Needed To Boost Retirement Savings

An examination of the experiences of other countries, especially Australia, may prove useful for U.S. policymakers as they consider ways to improve retirement savings rates among American workers, a white paper released by the nonprofit Retirement Solutions Foundation has suggested.

The study, "Filling America's Empty Nest Eggs: The Crisis Nobody's Talking About," was written by Retirement Solutions president Jane White. According to White, the average American has saved less than one fifth of the amount needed for a secure retirement, which pension actuaries estimate to be a multiple of 10 to 12 times the worker's final annual salary. Even after Social Security benefits are figured in, the study warned, the average worker can expect to replace less than 45% of his or her pre-retirement income.

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Yet, in Australia, where most workers save for retirement using defined contribution plans similar to 401(k) plans, White observed that workers tend to be much better prepared at retirement: Whereas the average American household between the ages of 62 and 65 currently has combined 401(k) and IRA savings of around $110,000, the average Australian household can expect to retire with a savings nest egg of around $535,000, excluding the value of the family home.

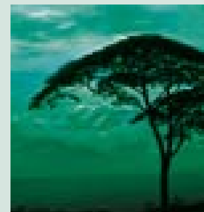
White attributed the significant difference in retirement savings between the two countries in part to the fact that, in Australia, employers are required to contribute to workers' defined contribution plan accounts, known as superannuation accounts. Currently, companies in Australia must contribute 9% of salary, up to a salary ceiling of $145,880. By contrast, employers in the U.S. typically only contribute to the 401(k) accounts of their workers in the form of matching contributions that tend to be significantly lower than the 9% mandated in Australia.

The paper also noted that, in Australia, workers are permitted to contribute a much larger percentage of their salary to their defined contribution accounts than is allowed in the United States, with the joint employer-employee contribution topping out at $50,000 for those under the age of 50 and at $100,000 for those over the age of 50. Moreover, Australian workers age 50 and older are allowed to sell a home or other asset and add the proceeds to their superannuation accounts. Indeed, White noted, these incentives have proven so attractive that employees in Australia are actually contributing more to their accounts than the 9% of salary contributed by their employers.

According to White, retirement savings in the United States have been eroded in recent years by a combination of the sharp decline in traditional pension plans and their replacement with the 401(k) plan, a retirement program originally intended to capitalize on tax breaks and add security to existing defined benefit plans—but not to be the sole source of retirement security.

Current proposals to encourage U.S. workers to save more for retirement, such as automatic enrollment in 401(k) plans, will likely prove ineffective, White asserted. Most automatic enrollment programs have a starting contribution rate of 3%—far below the amount needed to achieve retirement security, even for the youngest workers. Moreover, White pointed out, workers who change jobs frequently may continue to contribute at rates far too low to achieve adequate savings.

Instead of relying on automatic enrollment features or trying to bring back traditional pensions, White recommended that U.S. policymakers consider redesigning the 401(k) so that it looks more like its Australian counterpart. "To make a 401(k) plan walk, talk, and quack like a defined benefit plan, but without the counterintuitive DB shackles," White said, her organization proposes that companies with at least 10 employees contribute 9% of pay to a portable account. For smaller companies, the federal government could set up accounts for employees, matching voluntary contributions by workers and their employers with refundable tax credits. White also recommended that, as is the case in Australia, a much higher catch-up contribution ceiling be set for older defined contribution plan participants. To further improve retirement security, workers would not be permitted to access their 401(k) balances until retirement, and balances would have to be annuitized at retirement to ensure a lifetime income stream.



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