

# Employee Benefits Report



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Leave Benefits

December 2012

Volume 10 • Number 12

## Sick Leave Benefits

As the annual cold and flu season approaches, take an honest look at your organization's sick leave policies. Do they encourage employees to take needed time off when they are sick? Or do they encourage "presenteeism," which experts estimate costs more than \$150 billion annually in lost productivity?

**I**n January 2012, Connecticut became the first state to mandate paid time off for non-occupational illness. Connecticut's law applies to hourly wage service workers in businesses with 50 or more employees, who accrue one hour of paid sick time for every 40 hours

worked, up to five days per year. In addition, some cities, including San Francisco, Seattle and Washington, D.C., also require certain employers to provide paid sick time.

Currently, no federal law requires employers to provide paid sick leave, but many employers choose to do so. Among private industry workers, 52 percent at small establishments (fewer than 100 employees) and 82 percent at large establishments (500+ employees) had paid sick leave benefits, according to the March 2012 National Compensation Survey. Private employers with plans providing a fixed number of days of sick leave offered an average of eight paid sick days to employees after one year of service.

Sick leave benefits provide all or part of an employee's earnings if the employee is unable to

## This Just In...

**E**mployers whose employees have been affected by Hurricane Sandy and other natural disasters may be able to provide disaster relief payments as a tax-free benefit to employees. Section 139 of the Internal Revenue Code, created after the 9/11 terrorism events, allows charitable and other organizations, such as employers, to make tax-qualified disaster relief payments to individuals. Employers can deduct these payments as a business expense; employees do not need to provide substantiation.

To qualify, the disaster must result from a terrorist or military action, presidentially declared disaster or common carrier accident. Individuals receiving qualified disaster relief payments can exclude them from gross income. Section 139 defines a qualified disaster relief payment as "any amount paid



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work because of a non-work-related illness or injury. Sick leave typically is provided on a per-year basis, usually expressed in days, and is never insured.

In some organizations, in addition to sick leave, workers have coverage for short-term injury and illness through short-term disability plans. Also known as sickness and accident insurance, short-term disability plans often kick in after a worker has exhausted sick leave to provide full or partial pay if he or she cannot work because of a non-occupational accident or illness. Plans usually pay benefits for a fixed number of weeks, usually maxing out at six months. The benefit payment is either a percentage of an employee's earnings or a fixed dollar amount. Most plans require no employee contribution, although some employers offer short- and long-term disability insurance on a voluntary basis.

Some employers self-fund short-term disability benefits, but many others buy short-term disability insurance. California, Hawaii, New Jersey, New York and Rhode Island require employers to provide temporary disability insurance benefits to workers who are unable to work because of a non-work-related accident or illness.

Why should an employer consider offering paid sick leave benefits? Sick or medically impaired employees are less productive than healthy ones. If suffering a contagious disease, they can spread it to others. An employee who is sick or in pain is also less alert, which could lead to mistakes, errors of judgments or lack of coordination that could cause an injury or other safety problem.

Proponents say paid sick leave prevents "presenteeism," which a *Harvard Business Review* study defined as "the problem of workers' being on the job but, because of illness or other medical conditions, not fully functioning." A study in the *Journal of Occupational and Environmental Medicine* estimated that employees with chronic, contagious or other illnesses who show up and perform poorly account for two-thirds of health-related productivity losses, versus one-third for sick employees who miss work. The *Harvard Business Review* estimated that presenteeism "...costs U.S. companies over 150 billion dollars a year—much more than absenteeism does."

Economic conditions have made the presenteeism problem worse, as employees hesitate to take time off for fear of losing their job. In fact, in a recent survey by EAP provider CompPsych Corp., 22 percent of employees see "being present" as their top priority at work, versus ac-

**to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; or the repair or rehabilitation of a personal residence or its contents needed due to a qualified disaster."**

**For more information on providing disaster-relief benefits, please contact your tax or legal advisor. For information on other benefits that can help employees deal with disaster, such as homeowners and accident insurance at group rates, please contact us.**

complishing their basic responsibilities or improving their performance.

Despite employer fears to the contrary, most employees will not abuse sick leave benefits. A study by the Institute for Women's Policy Research found that the typical worker with access to sick leave benefits under San Francisco's law used only three paid sick days during the previous year, while one-quarter of employees used none. This occurred despite the fact that San Francisco's leave law provides up to either five or nine sick days per year, depending on hours worked.

Structuring a sick leave plan can present several challenges to an employer.

- ✦ How does an employer balance the need to provide sick leave for valid reasons, while discouraging employees from using sick leave as paid vacation? Allowing employees to cash in unused sick days at the end of the year could discourage the use of sick days as extra vacation days, but it might tempt some sick employees to come to work when they should stay home.
- ✦ Should employers allow employees to carry over unused sick days to the next year, to build up a sick leave reserve for serious illness or surgery? Or would a short-term disability insurance plan better serve your needs?
- ✦ How can employers prevent employees from using sick days for other, "personal" purposes that could be scheduled in advance? Would a paid leave bank that combines vacation, sick days and personal days into one package encourage better communication and help avoid unplanned absences?

We can help you evaluate several alternatives, including short-term disability insurance, for your organization's sick leave benefits. For more information, please contact us. ■

# Plan Loans vs. Hardship Withdrawals

Plan loans and hardship withdrawals offer participants in defined contribution retirement plans additional financial flexibility and short-term financial relief—if used judiciously.

**S**ponsors of defined contribution plans can structure their plans to allow participants to take loans and hardship withdrawals from their accounts. According to the Plan Sponsor Council of America (PSCA), 89 percent of 401(k) plans permit loans, while 90.5 percent allow hardship withdrawals.

## Plan Loans

In order to permit loans, your organization's plan document must outline application procedures and the plans policy for granting loans. Plans may place limitations on the amounts, purpose or number of loans available, but all loans must meet these criteria:

- ✦ Loans cannot exceed 50 percent of the vested account balance or \$50,000, whichever is less. (A plan may make an exception to the loan limit rule by allowing participants who have vested account balances of less than \$10,000 to borrow up to \$10,000.)
- ✦ Plans may allow participants to have more than one outstanding loan at a time. However, the outstanding balance of all of the participant's loans in the plan cannot be more than \$50,000.
- ✦ The participant must repay the loan within five years, unless it is used to buy



- a principal residence. Plans can allow a longer repayment term, such as 15 years.
- ✦ The participant must make at least quarterly payments on the loan; repayment amounts must be “substantially level” over the life of the loan. (Employers may, but are not required to, use payroll deduction for repayments. This helps prevent default.)
- ✦ The loan must charge a “reasonable” rate of interest, commensurate with rates charged by independent lenders for similar loans, and be adequately secured.

401(k) loans have advantages over many other types of loans. These include:

- ✦ No credit check. A 401(k) loan will not affect the plan participant's credit rating.
- ✦ Easy approval. Participants typically fill out a short form requesting the loan; no underwriting is required.
- ✦ The borrower makes interest payments to him/herself, rather than an outside lender. As the Federal Reserve Board puts it, “since the ‘borrowed’ assets are already owned, a 401(k) loan is less a loan than a pre-retirement withdrawal coupled with

a schedule of automatic account contributions.” This feature can make a 401(k) loan cost less than a comparable consumer loan.

- ✱ The borrower incurs no penalties or taxes on the withdrawal, as long as he/she makes repayments.
- ✱ There are no regulatory restrictions on how the proceeds from a 401(k) loan may be used.

### Hardship Withdrawals

Hardship withdrawal provisions allow employees access to their own funds when they have special needs. But that access comes at a cost. Participants taking hardship withdrawals must pay federal and state income taxes on the withdrawal amount. Employees who receive distributions before age 59 ½ will pay an additional early distribution penalty of 10 percent, unless an exception applies.

If your plan permits, participants can make hardship withdrawals for:

- ✱ Medical care expenses for themselves, a spouse or dependents;
- ✱ Costs directly related to the purchase of a principal residence (excluding mortgage payments);
- ✱ Postsecondary education expenses for themselves, a spouse, children or dependents;
- ✱ Payments necessary to prevent the eviction from or foreclosure on a principal residence;
- ✱ Funeral expenses; or

- ✱ Repair of damage to their principal residence.

Hardship withdrawals cannot be repaid, so they will reduce an employee’s retirement savings. Further, when participants take a hardship withdrawal, they must suspend all contributions to their plans for six months following the withdrawal. This also prevents them from obtaining employer matching contributions.

A short-term plan loan might have minimal effects on an employee’s retirement savings, depending on market conditions. Problems can arise, however, when participants lose their job or are otherwise unable to repay the loan. According to a study conducted by the Financial Literacy Center, almost 10 percent of all 401(k) participants with loans from 2005-08 defaulted on their loans for reasons relating to job separation. Participants who have been terminated can take up to 60 days to repay a plan loan. After that, the loan becomes a taxable distribution, and subject to the early distribution penalty if the participant is younger than 59 ½.

Although hardship withdrawals and defaulted loans reduce funds available at retirement, many experts think that providing these options helps increase plan participation. Employees who lack other emergency funds might be unwilling to put their money into an illiquid 401(k). The availability of plan loans and hardship withdrawals can make 401(k)s a more appealing savings vehicle. For more information on 401(k)s and other retirement plans, please contact us. ■

## 2013 Plan Changes

Here are some important updates for your benefit plans.

### Flexible Spending Accounts (FSAs):

- 1 The new \$2,500 limit on FSA contributions goes into effect on January 1, 2013. If your plan goes into effect after January 1, limits must be pro-rated. Update your plan documents and communications accordingly.
- 2 Remind employees that they will forfeit balances unused by year end. Plans that have been amended to offer a grace period can allow participants another 2 ½ months to use their funds (March 15 for calendar-year plans).
- 3 Enrollment does NOT carry forward year to year, so remind participants to re-enroll for 2013.
- 4 Complete any nondiscrimination testing required.

### 401(k)s:

- 1 Update plan documents and communications to reflect new limits. For 2013, deferral contribution limits increase to \$17,500 for traditional and safe harbor 401(k)s, and to \$12,000 for SIMPLE 401(k)s. The maximum additional “catch-up” contribution for employees age 50+ remains \$5,500.

**2** Update plan documents and procedures to reflect the updated “annual addition” limit for 2013. The \$56,500 limit includes elective deferrals, catch-up contributions, employer matches, employer nonelective contributions and allocations of forfeitures. Total contributions cannot exceed the employee’s compensation.

**Health Insurance Plans:** Update plan documents and communications to reflect new limits for health savings account (HSA)-qualified high-deductible health plans. In 2013, minimum deductibles for these plans increase to \$1,250 for individual coverage and \$2,500 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) cannot exceed \$6,250 (individual) or \$12,500 (family).

**Long-Term Care Plans:** Insureds can deduct a portion of long-term care insurance policy premiums, based on age. Deductibility levels will increase for 2013 to \$360 for individuals age 40 or less, \$680 for individuals between ages 41-50, \$1,360 for individuals 51-60, \$3,640 for individuals ages 61-70, and to \$4,550 for individuals ages 71+.

**Transit Benefits:** Despite efforts to restore parity for limits on transit and parking benefits, at press time the 2013 limit on qualified mass transit benefits (\$125 per month) remained lower than the limit for qualified park-

ing benefits (\$240 per month). Employers can generally exclude the value of these benefits from employees’ wages.

For purposes of these benefits, “mass transit” includes publicly or privately operated bus, rail or ferry transit and qualified “commuter highway vehicle” transit service, and that is operated by a person. Qualified parking benefits include parking on or near the location from which your employees commute to work using mass transit, commuter highway vehicles, or carpools. They do not include parking at or near your employee’s home.

**Payroll:** All employers that filed 250 or more W-2 forms for 2011 must report the costs of employer-sponsored group health coverage on employees’ W-2 forms for 2012. This includes portions paid by both the employer and the employee, except for health FSAs, where the amount reported should not include the employee’s salary reduction contributions. An employer does not have to issue a W-2 to report healthcare costs of retirees, employees or former employees to whom the employer would not otherwise provide a Form W-2.

We can help you review your benefit plans and procedures to ensure you are in compliance with existing limits and rules. Please contact us for more information. ■



## Update on Retiree Health Benefits

**P**ivate-sector employers are not required to provide retiree health benefits. Furthermore, when employers do offer retiree health benefits, nothing in federal law prevents them from cutting or eliminating those benefits—unless they have made a specific promise to maintain the benefits.

**M**ercer's 2011 survey of employer health benefits found that 16 percent of employers with 500 or more workers offered Medicare-eligible retirees health benefits—down from 40 percent in 1993. Of those currently offering retiree health benefits, about one-third said they might drop it in the next five years. The Employee Benefits Research Institute recently reported that, “most [employers] that have continued to offer retiree health benefits have made changes in the benefit package they offer: raising premiums that retirees are required to pay, tightening eligibility, limiting or reducing benefits, or some combination of

these.” Further, it reports that 43 percent of employers say they are “very likely to increase the retirees’ portion of premiums next year, and another 35 percent are somewhat likely to do so.” This marks a dramatic increase in cost-sharing since 1988, when Bureau of Labor Statistics data indicate that more than half of those offered retiree health coverage had benefits funded entirely by their employer.

**W**ith the Affordable Care Act and economic pressures, more employers might turn to coverage through private exchanges for their Medicare-eligible retirees. In many parts of the country, employers can now refer employees to exchanges that offer Medicare supplement or Medicare Advantage policies from multiple employers. Using a defined contribution approach, such as a health reimbursement arrangement (HRA), employers can cap their expenses while still providing a valuable benefit to retirees.

For more information, please contact us. ■

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