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This Just In

The Flex Health Savings Accounts Act, now before Congress, would raise the limit on HSA contributions and make the tax deduction for contributions to health savings accounts available to holders of flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs). Current law limits HSA contributions to the amount of the deductible for the high-deductible health plan (HDHP) or $2,700 for individual coverage ($5,450 for family coverage), whichever is less. The legislation would eliminate the "lesser of" requirement, allowing annual deductible contributions up to the maximum statutory limit. With support from House Speaker Dennis Hastert (R-IL), chances are good that the measure will receive some attention this year.

About one-quarter of large U.S. companies expect to add automatic enrollment to their 401(k) plans in 2006, according a recent Hewitt Associates study. The move reflects employer concerns about employees' savings habits – only about six percent of companies surveyed have confidence that workers are actively planning for retirement. Although the majority of companies offering pension plans are not likely to adjust them in 2006, some employers are making changes: 15 percent are very likely to close participation to new employees, six percent plan to freeze accruals and five percent intend to modify their plan design. If you're making changes, consider automatic enrollment to enhance your employees' retirement savings rate.

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Benefits Administration

COBRA Benefits: What You Need to Know

Today's workforce is more mobile than ever, with multiple job changes the rule rather than the exception. Many employees rely on the Consolidated Omnibus Budget Reconciliation Act of 1985, better known as COBRA, to maintain health benefits during job transitions and other life events. COBRA allows workers and family members who would otherwise lose their benefits to temporarily continue health coverage at group rates.

If you had 20 or more employees in the prior year and offer a group health plan, COBRA applies to your company. (Your employee count must include part-time employees; add part-timers' hours together to determine the number of full-time equivalents.) Here is what you need to know about COBRA's requirements:

Qualified beneficiaries. Eligibility for benefits under COBRA is limited to qualified beneficiaries, i.e., those covered by a group health plan on the day before a qualifying event (see below). Typically, this includes full-time and part-time employees who are plan participants, their spouses and dependents, as well as retirees, unless they are eligible for Medicare. Employers do not have to offer COBRA coverage to any employee who is not yet eligible for group health coverage or who declined to participate in the plan.

Qualifying events. Certain events will trigger the right to coverage under COBRA, including termination of employment (voluntary or involuntary), unless it is for gross misconduct, and reduction in hours worked (e.g., from full-time to part-time). An employee's death, divorce, legal separation or eligibility for Medicare are all considered qualifying events, as is a change in status of a covered dependent or spouse. Being called up for active military duty also triggers eligibility for COBRA coverage when an employer doesn't voluntarily maintain a reservist's health coverage. The type of qualifying event determines who the qualified beneficiaries are and the amount of time that a plan must offer the health coverage to them under COBRA.

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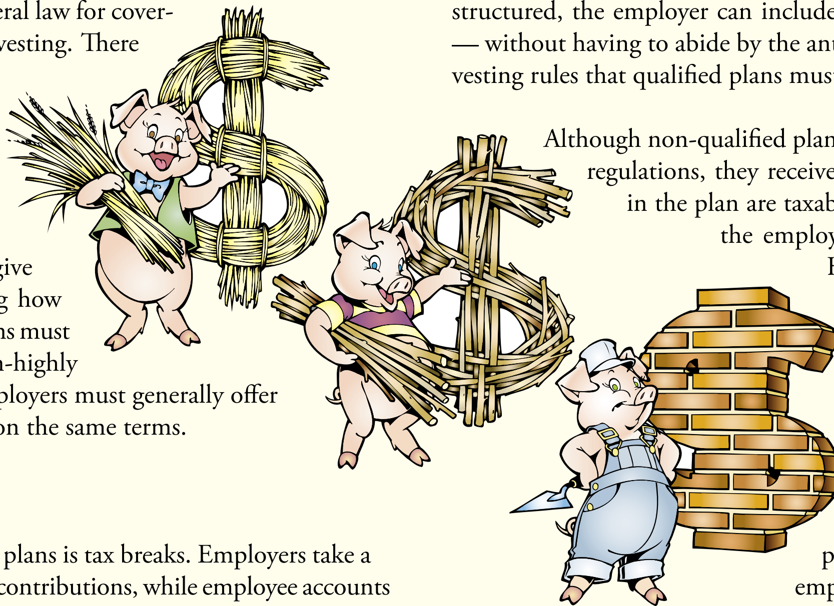
Qualified vs. Non-Qualified Retirement Plans

Choosing a retirement plan for your employees sounds straightforward, but the myriad of options available — not to mention complicated tax rules — leaves many employers uncertain about the best fit for their company. One of the basic decisions employers face is whether to offer qualified or non-qualified retirement plans, or some combination of both. Here's a closer look at the pros and cons of each.

Qualified retirement plans are employer-sponsored retirement plans that "qualify" participants for certain tax benefits by meeting requirements under federal law for coverage, participation, funding and vesting. There are two main types of qualified plans: defined benefit plans, which are funded by company contributions to meet a preset annual retirement payout, and defined contribution plans, such as profit-sharing plans, which give employers flexibility in choosing how much to contribute each year. Plans must cover at least 70 percent of non-highly compensated employees and employers must generally offer them to all full-time employees on the same terms.



Tax advantages

The major attraction of qualified plans is tax breaks. Employers take a current tax deduction for all plan contributions, while employee accounts grow tax-free until the time of distribution. Some plans do not require the employer to make annual contributions. Employer contributions to qualified plans are held in trust until the employee is entitled to receive them, an arrangement that helps assure employees that the money will actually be there when they retire.

Qualified plans, however, have several drawbacks. Any time an employer makes a contribution, it must make contributions on behalf of all participants. Some plans require employers to make annual contributions whether or not the company is profitable. Benefits are not guaranteed in most plans (although federal law protects participants' rights), and participants face a substantial penalty for early withdrawals.

In recent years, qualified plans have become less attractive for two reasons: regulatory changes keep whittling down the maximum amount of money that employers can contribute to them and increasingly complex rules are burdening employers with higher administrative costs. This has led to reduced qualified plan benefits for many valuable employees and has limited employers' ability to adequately compensate these workers. In response, some companies have turned to non-qualified plans to replace the lost benefits.

Non-qualified plans are employer-sponsored plans designed to benefit a select group of executive or key employees. If the plan is properly structured, the employer can include only those employees it chooses — without having to abide by the anti-discrimination, participation or vesting rules that qualified plans must follow.

Although non-qualified plans are subject to fewer government regulations, they receive fewer tax benefits. Any earnings in the plan are taxable to the employer and taxable to the employee when distributed as benefits. However, the employer can take a tax deduction at the time of distribution. And since non-qualified plan contributions are not held in a separate trust, employees receive no guarantee that benefits will be there when they retire — and any assets set aside for future payouts are subject to claims by employers' creditors.

Irrevocable trusts

One way to reduce the potential financial risk to non-qualified benefits is by setting up an IRS-approved irrevocable trust into which the employer contributes the plan assets, which are managed and distributed by the trustee. Although these trusts do not protect the assets against creditors' claims in case of company insolvency, they generally offer protection in the event of a corporate takeover, change in management or other event that could threaten the availability of benefits.

Without a requirement that non-qualified plan assets be held in trust, many companies pay non-qualified benefits out of general corporate assets as they become due. This approach assumes that future growth of the company will cover its

Qualified vs. nonqualified retirement plans

	Qualified	Nonqualified
Employer contributions deductible as business expense	Yes	No
Investment earnings grow tax-free until withdrawal	Yes	No
Participants' rights protected by federal law	Yes	No
Can cover only a specific class of employees	No	Yes
Give employers flexibility to reward highly compensated employees	No	Yes

Retirement – continued on Page 4

Caring for Contingent Workers

Whether they are temporary, leased or independent contractors, "contingent workers" make up the fastest-growing part of the nation's workforce. If your company benefits from temporary talent, here's what you need to know about providing benefits for these workers.

Contingent workers come from a variety of sources. Very often temporary employees are recruited, hired, employed and paid by a temporary staffing agency. The agency assigns the worker to temporary jobs within client companies, generally to supplement the company's own workforce. During the assignment, the temporary employee works under the supervision of the client company; however, the temporary agency provides his/her pay and benefits.

Leased employees are part of a staffing arrangement where a leasing firm "employs" company personnel, handling payroll, taxes, benefits and other HR functions. Some leasing firms supply companies with an entire staff of employees for extended time periods.

Independent contractors are also part of the contingent work force. These self-employed workers contract with employers to perform specified tasks. Usually paid on a fee for service basis, they are free to provide services to other companies while they also work for you. Independent contractors do not generally qualify for traditional employee benefits.

In almost all temporary or leasing situations, your company and the staffing agency or leasing firm are considered joint employers. While the agency or firm is the primary employer, both entities have some responsibility for providing employee benefits. Who provides what portion of benefits depends upon your relationship with the staffing agency — and the benefits offered to your permanent employees.

To reduce your company's share of benefits for temporary workers, employment law experts offer this advice:

- **Relinquish control.** A good rule of thumb is to defer control and responsibility to the staffing agency, so that temporary workers are clearly distinguished from your regular employees. Recruiting, training, job assignments, firing, complaints, raises and payroll issues, expense reimbursement all of these should be handled by the staffing agency as much as possible.
- **Differentiate workers.** Employers should also set up clear differences between temporary and permanent staff. This means that temporary workers should ordinarily be excluded from using company facilities like gyms and stores. Even badges or other employee identification should be distinct from those of permanent staff.
- **Compare plans.** Using a staffing agency or leasing firm might resolve issues of plan participation and eligibility. While temporary workers may be employees of both the agency and the company, the precise consequences of dual employment for benefit plan purposes remains unclear. Employers should know and understand exactly what benefits the temporary agency offers. Comparing the agency's benefits to those offered by the company helps employers assess risk in case an employee is misclassified. Before signing up with a temporary agency or leasing firm, investigate to make sure it is reputable, financially stable, and that the staffing or leasing plans don't violate IRS or other federal employment guidelines. While federal law does not prohibit joint employers from excluding contingent staff from employee benefit plans, there are exceptions. If an employee is otherwise eligible, an employer can't impose minimum age or length-of-service requirements to deny participation.

- **Equal treatment over time.** Temporary employees who have worked full-time for an employer for at least one year must also be treated as regular employees for retirement plan purposes. However, your company might not have to cover the worker if the staffing agency or leasing firm provides a suitable plan. If the company chooses to provide the benefit, temporary workers must meet the same eligibility rules as regular employees, such as job tenure and minimum hours requirements.

"Temporary employees who have worked full-time for an employer for at least one year must also be treated as regular employees for retirement plan purposes."

- **FMLA eligibility.** In addition to equal treatment, leased and temporary employees are eligible for Family and Medical Leave Act (FMLA) protection as long as they meet the other requirements for coverage. Under FMLA, joint employers must both count the temporary/leased employee in staffing levels to determine employee coverage and employer liability. As primary employer, the temporary agency/leasing firm is responsible for giving required notice to the employees, providing FMLA leave and maintaining health benefits.

For further information about benefits for contingent workers, please contact us. ❏

COBRA – continued from Page 1

Types of coverage. Employers must offer identical health care coverage to COBRA beneficiaries as they do to non-COBRA beneficiaries – usually the same plan that was in place immediately before the qualifying event. Any benefit changes for active employees will also apply to COBRA beneficiaries, who are entitled to the same coverage choices as all other employees, such as during periods of open enrollment.

Length of coverage. COBRA provides for up to 18 months' coverage for qualifying events such as job termination or a reduced work schedule. Certain qualifying events, or a second qualifying event during the initial coverage period, may extend coverage to a maximum of 36 months. Employers may also provide coverage beyond COBRA maximums. Coverage begins on the date that benefits would otherwise have been lost because of a qualifying event. It may end earlier than the maximum period if the beneficiary does not pay premiums on time or if the employer stops offering any group health plan.

Notification and election. Employers must notify covered employees and their spouses of their rights under COBRA when they first join the company's health care plan. Be sure to have a calendar handy to keep track of the various COBRA deadlines: Employers must inform plan administrators of a qualifying event within 30 days after an employee's death, termination, reduced hours of employment or entitlement to Medicare.

In the case of divorce, legal separation or a dependent's change of status, a qualified beneficiary has 60 days to notify the administrator. The administrator then has two weeks to notify the person entitled to COBRA benefits, who must decide within 60 days whether to elect coverage. Keep in mind that though an employee may choose coverage on behalf of all other qualified beneficiaries, each beneficiary has the right to independently elect COBRA coverage. For example, if an employee has a family member with an illness at the time he is terminated, that person can elect coverage alone, should he choose.

Cost of coverage. In most cases, the employee pays the full cost of the insurance premiums, though some companies subsidize COBRA coverage. In fact, companies may charge up to 102 percent of the premium and keep the two percent to cover administrative costs. Premiums may be increased if costs to the plan increase but generally must be fixed before each yearly premium cycle. The beneficiary must make the initial premium payment within 45 days after the election date, and employers can terminate COBRA coverage if payments are late. The fact that most insurers require payment in advance for coverage complicates the process, because while companies pay in advance, COBRA insureds get a 30-day grace period from the time the payment is due.

Special rules apply to reservists called up for military service. If military service is for 30 or fewer days, the employee and dependents can continue coverage at the same cost as before their short service. If military service is longer, you can require the employee and dependents to pay as much as 102 percent of the full premium for coverage. However, military health care should cover these employees and their dependents.

State law. Most states have laws concerning the continuation of benefits. Some cover all employers, including small employers, so you might be subject to a state law even if your company is exempt under the federal COBRA law. To find out more about your state's laws regarding continuation of coverage, contact your state labor agency or a legal professional. Be sure to inquire about the types of benefit plans covered, eligibility rules, what constitutes a qualifying event, notification requirements, length of coverage and how coverage may be terminated.

Complying with COBRA can be challenging, but for now it's a necessary part of your company's benefits administration. For assistance with COBRA compliance, please contact us. ❑

RETIREMENT – continued from Page 2

benefit obligations. This arrangement might strain the coffers of smaller companies on payout day and leave executives wondering about the security of their benefits.

An alternative to the pay-as-you-go approach is to create an asset reserve for future plan obligations by using corporate-owned life insurance (COLI). Typically, the company buys a cash value life insurance policy — either whole life or universal life — on the life of the key employee and names itself as beneficiary. The employer owns the policy and pays all premiums. After the employee retires, the company can use the policy's cash value to pay the benefit. If the employee dies, the policy pays a tax-free death benefit to the company.

The advantage of funding with COLI is that the cash accumulation inside the policy grows tax-free. However, COLI offers no protection against any creditor's claims, so it won't provide an employee total peace of mind. A trust can hold the COLI; however, trusts have tax implications for both the employer and the participant.

We can work with your tax professional to help you set up a nonqualified plan that benefits both your company and your highly compensated employees. Please call us for more information. ❑

Retirement plan fees will continue to fall through 2006, according to recent analysis by 401khelpcenter.com. Competitive pressure on funds to reduce management fees, regulatory scrutiny, and financial industry consolidation have contributed to lower retirement plan costs. But don't expect that just because fees are dropping in general that your company will benefit automatically. Employers must engage in negotiations and benchmarking with providers to ensure the lowest plan costs for both participants and sponsors. Urge your provider to separate management fees from servicing and marketing fees in mutual fund expense ratios.

One in four U.S. companies lacks a benefits policy for expatriate workers, according to a recent Mercer Human Resources Consulting survey. At the same time, 60 percent of companies are increasing their use of short-term international assignments. Almost all respondents agreed that addressing benefits issues for globally mobile employees is a medium or top priority. If your company operates globally, we can help you make sure your benefits meet the needs of your overseas workers.

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