BENEFIT Plan Developments

A monthly report covering plan design and legislative changes Volume 48, Number 10

Hurricane Katrina Raises HR Issues

To help survivors of Hurricane Katrina recover from their losses, Congress has passed a $6.1 billion law providing tax relief to affected individuals and businesses, while the Internal Revenue Service (IRS) and the U.S. Department of Labor (DOL) have eased the rules on 401(k) distributions, leave-based donation programs, and tax-filing deadlines. Federal agencies have also issued guidance to employers and employees impacted by the disaster regarding their employee health and insurance plan obligations.

The DOL said it would not treat any person as having violated ERISA for taking advantage of the provisions of IRS Announcement 2005-70, which permits Katrina survivors to make hardship and loan withdrawals from 401(k) and other qualified employer-sponsored plans without providing the usual documentation.

"Helping Hurricane Katrina's survivors get back on their feet is our highest priority," said Secretary of Labor Elaine L. Chao. "These actions will make it easier for those in need to get hardship withdrawals and loans from their 401(k)s and similar plans so they can begin rebuilding their lives."

The IRS issued guidance stating that retirement plans may offer this relief to Katrina victims and their families who live or work in the disaster area to help them repair or replace their homes, or for some other purpose, such as food and shelter. People who live in other parts of the country are also allowed to use 401(k) loans or hardship distributions to help family members who lived or worked in the disaster area. Any withdrawals made by plan participants under the age of 59½ would, however, be subject to taxes and the usual penalty of 10% for early distributions. Loans remain tax free if they are repaid within five years.

The IRS announcement allows plan sponsors to make these loans and hardship distributions before the plan is formally amended to provide for these features, and permits employers to relax the requirement that participants produce certain documentation to justify hardship distributions. The six-month ban on new 401(k) contributions for employees who take hardship distribu-

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J & D Goodliffe Associates, Inc.

P.O. Box 1309
Mountainside, NJ 07092

908•233•2800 - Phone
908•233•2804 - Fax
judie@goodliffeassoc.com

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The six-month ban on new 401(k) contributions for employees who take hardship distributions will not apply to Hurricane Katrina survivors.

tions will not apply to Hurricane Katrina survivors. Hardship withdrawals must be made by March 31, 2006.

"As in other areas, we are doing everything we can to help Hurricane Katrina victims rebuild their lives," said IRS Commissioner Mark W. Everson. "This relief will make it possible for people to get their retirement money more quickly with a minimum of red tape."

The IRS also granted in Notice 2005-68 special tax relief for leave-based charitable donation programs aiding survivors of Hurricane Katrina. Under the new rules, employees who forgo vacation time or other forms of paid leave in exchange for employer cash payments to hurricane relief organizations do not have to include the donated leave in their income. Employers making cash payments to these charities on behalf of employees before January 1, 2007 are permitted to deduct these payments as an ordinary and necessary business expense, rather than as a charitable contribution.

Signed into law by President Bush on Sept. 23, the Katrina Emergency Tax Relief Act of 2005 provides additional tax relief for Katrina victims. Among other provisions, the new legislation waives the 10% penalty for premature distributions from 401(k)s and IRAs, raises the limit on loans from qualified retirement plans from $50,000 to $100,000, and allows retirement plan participants to pay income tax on distributions over three years.

The legislation also includes a two-year extension of the Work Opportunity Tax Credit (WOTC) to Gulf Coast employers hiring workers who lived in the disaster area before the hurricane and became unemployed as a result of damage or destruction to their previous places of employment. Small employers whose businesses were damaged in Hurricane Katrina may claim a tax credit equal to 40% of the first $6,000 on wages paid to employees through the end of the year. In addition, the law contains enhanced deductions for businesses contributing cash and certain items to hurricane victims.

On Sept. 19, the DOL, the IRS, and the Treasury Dept. issued a notice extending Consolidated Omnibus Budget Reconciliation Act (COBRA) and Health Insurance Portability and Accountability Act (HIPAA) deadlines for health plan coverage for employers and employees affected by the hurricane. These extensions give Katrina victims who are without health insurance additional time to request enrollment in another group plan, and secure new insurance without losing coverage for pre-existing conditions. The modified rules also allow victims more than the currently mandated 60 days to request COBRA coverage, and provide them with more time to make their COBRA payments. In addition, the time frames for HIPAA- and COBRA-related disclosures have been extended for plan sponsors affected by the storm.

Smaller Employers Struggling To Cope With Rising Health Benefit Costs

Despite a decline in the rate of health insurance premium growth in 2005, the number of businesses offering health benefits to their employees continues to fall. Smaller companies, in particular, are turning to cost-sharing and other cost-containment strategies to keep up with increases that remain well above inflation, according to two recent studies.

The Kaiser Family Foundation's "Employer Health Benefits Survey" found that insurance premiums for employer-sponsored health plans rose at an average rate of 9.2% in 2005, down from 11.2% in 2004, and 13.9% in 2003. But even this year's single-digit increase was much higher than the overall inflation rate of 3.5% and average wage gains of 2.7% over the same period, researchers

observed. In 2005, the average annual premiums for employer-sponsored health plans reached $10,880 for family coverage, and $4,024 for single coverage.

Some companies have reacted to these sharp increases by dropping health benefits altogether, the survey indicated. The percentage of all employers offering health benefits to their workers fell to 60% in 2005, from 69% in 2000. Over this five-year period, researchers noted, premiums for family coverage increased by 73%—far outpacing inflation growth of 14% and wage gains of 15%.

A growing share of employers who continue to provide health benefits are turning to consumer-directed approaches in an effort to trim costs. Of those firms with health plans, 20% now offer a high-deductible health plan (HDHP) to at least some of their employees, the survey found.

The survey also indicated that small, but growing, numbers of employees may now choose a consumer-driven plan, with 1.6 million workers now covered by an HDHP with a health reimbursement arrangement (HRA) through their employers, and 810,000 employees covered by a high-deductible plan coupled with a health savings account (HSA). Researchers found that the total annual spending by employers for HDHP/HRAs, including premiums plus contributions, was not significantly lower than for health plans generally. Employers did, however, appear to spend less on HSA qualified HDHPs.

"Consumer-driven plans are proving attractive to some, but with just a couple million people now enrolled, it's too early to know whether they'll have a meaningful effect on the health system," said Gary Claxton, a Kaiser Family Foundation vice president and co-author of the study. "The jury is still out on whether employees feel that these arrangements work for them, particularly when they get sick, and on whether employers feel that they have a real impact on costs."

Preferred provider organizations (PPOs) cover 61% of workers, but PPOs were found to be the most expensive plan type, with average annual premiums of $11,090 for family coverage in 2005. In contrast, the average annual premiums for less-popular health maintenance organizations (HMOs), which cover 21% of workers, came to $10,456 for family coverage, according to the survey.

Nearly 80% of insured employees with single coverage, and 90% with family coverage, contribute toward their health insurance premiums, results showed. On average, employees contribute $610 for single coverage, and $2,713 for family coverage. However, researchers said, employees in smaller companies tend to make significantly higher contributions toward family coverage than workers employed by larger companies.

While the percentage of premiums paid by employees has remained unchanged over the past several years at an average of 16% for single coverage and 26% for family coverage, the study revealed that employee cost sharing—in the form of deductibles, copayments, and coinsurance—is now substantial, especially for workers in small companies.

In an effort to hold down costs, the Kaiser Foundation study concluded, employers are turning to cost sharing, disease management, and, increasingly, consumer-driven approaches. But, researchers noted, with the average cost of family coverage now exceeding the full-time wages of a minimum-wage worker, smaller companies in particular are finding it increasingly difficult to offer benefits to workers.

Salary.com's "Small Business Basic Medical Coverage Survey" also concluded that the relentless rise in health insurance premiums is having a disproportionate effect on small companies. In a survey of 304 small businesses (1-200 employees), almost 90% of respondents said they were paying more to provide basic health coverage to employees in 2005 than in 2004, with half reporting year-on-year increases of 10% to 20%.

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Of the small companies surveyed, 64% said they were using one or more strategies to keep health insurance costs in check, including increasing employee copayments and, to a lesser extent, the employee share of premiums. Other cost-containment strategies cited by respondents were switching plans, reducing coverage levels, changing eligibility standards, and eliminating coverage altogether. Results showed that raising the amount employees contribute to premiums is the fastest-growing cost-containment measure among small businesses, with a large percentage of the employers surveyed saying they would be likely to adopt this practice in the future.

The Salary.com survey also revealed that some small businesses (14%) are even offering employees incentives not to participate in the company's group plan, or are actively encouraging them to enroll in their spouse's plan. Among the incentives mentioned by respondents were lump-sum salary increases, cash rebates, and contributions to other benefit accounts.

Tax Breaks On Long-Term Care Insurance Premiums Proposed

Two bills that would allow employees to use their 401(k) and 403(b) plans to purchase long-term care insurance (LTCI) with pre-tax dollars, and without incurring penalties, are making their way through the House and Senate.

In September, Sen. George Allen (R-VA) reintroduced legislation offering these tax incentives for buying LTCI, S. 1706, the Long-Term Care Act of 2005. A companion bill in the House, H.R. 976, would permit people to use their IRAs, as well as their employer-sponsored defined contribution plans, to pay for LTCI premiums.

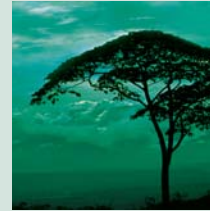
Commenting on the proposed legislation, Merrill Matthews, director of the Council for Affordable Health Insurance, said, "The Long-Term Care Act is a win-win solution. Many Americans are already saving in their retirement plans to have a comfortable life once they become seniors. By allowing individuals to pay LTCI premiums with their tax-deferred savings, it encourages people to get coverage while they are younger when premiums are more affordable; and if they ever happen to need the plan, their retirement savings won't be wiped out. CAHI applauds Sen. Allen for introducing this legislation."

Rising Health And Energy Costs Bite Into 2006 Pay Raises

As rapidly rising energy and health care benefit costs take their toll on businesses and consumers, many employers predict there will be little room in their budgets for substantial above-inflation pay increases in 2006, according to a study by Hewitt Associates.

The survey of 1,056 large companies showed that, on average, employers expect to award base salary raises of 3.6% to non-executive salaried employees, 3.8% to executive employees, 3.1% to union employees, and 3.5% to non-union hourly workers. Even with these pay increases, researchers predicted, the rapid growth in medical insurance premiums and gas prices will likely eat into employees' paychecks over the next year.

At the same time, the study found, some employers are using variable pay to help make up for flat base pay increases. Results showed that, in 2005, average spending on variable pay as a percentage of payroll increased to 11.4%, from 9.5% in 2004. More than three-quarters of companies are now using some form of variable pay, the survey found, up from 51% in 1991.



By allowing individuals to pay LTCI premiums with their tax-deferred savings, it encourages people to get coverage while they are younger when premiums are more affordable.