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HR and Benefits Update

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Grace Period Does Not Extend Timeframe to Purchase OTC drugs in 2011

Many flexible spending accounts (FSAs) include a grace period, which gives participants an additional two-and-a-half months after the end of the plan year to incur qualified medical expenses before unused balances are forfeited under the "use it or lose it" rule. For calendar plan years, the grace period occurs from Jan. 1, 2011, through March 15, 2011. As a result, a grace period's interaction with the changes under health care reform is important to consider.

Health care reform includes a provision that does not permit over-the-counter (OTC) drug expenses incurred in tax years beginning after Dec. 31, 2010, to be reimbursed from an FSA, unless they are drugs or insulin prescribed by a physician. Due to the effective date provided within the law, OTC drug expenses incurred on Jan. 1, 2011, may not be reimbursed without a prescription, regardless of whether there is a grace period. Thus, a grace period does not extend the timeframe to purchase OTC drugs in 2011.

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Grace Period Does Not Extend Timeframe to Purchase OTC drugs in 2011 *continued*

This change also occurs regardless of the FSA plan year. For example, an FSA with a fiscal plan year of April 1, 2010, through March 30, 2011, needs to ensure that OTC claims incurred on or after Jan. 1, 2011, are not reimbursed without a prescription.

Finally, another important point to consider involves a plan's "run-out period." A run-out period differs from a grace period in that the run-out period simply provides additional time to submit already-incurred claims. A plan that includes a run-out period may continue to reimburse OTC expenses, as long as these expenses were incurred by Dec. 31, 2010.

2011 Retirement Plan Limits: Unchanged From 2010

The Internal Revenue Service recently announced cost of living adjustments applicable to retirement plan contribution limits for 2011. As a result of low inflation over the previous 12 months, the contribution limits remain unchanged. The table below shows the 2010 and 2011 contribution limits for 401(k) plans. For more information about retirement plan limits, please contact your plan consultant or visit www.irs.gov/retirement.

401(k) Plan Limits for Plan Year 2011:

- 401(k) Elective Deferrals – $16,500
- Annual Defined Contribution Limit – $49,000
- Annual Compensation Limit – $245,000
- Catch-up Contribution Limit – $5,500
- Definition of Highly Compensated Employee – $110,000
- Social Security Wage Base – $106,800

Compliance FAQ

Question: Can we drop employees age 65 or older from the group plan and pay them to go on Medicare?

Answer: If the employer has 20 or more employees and the individual is an active employee, the group health plan may not "take into account" an employee or a spouse's entitlement to Medicare and must provide the individual with the same benefits under the same conditions as other employees. This provision does not apply to retirees. In addition, the regulations emphasize that an employer that offers a financial incentive not to enroll or to terminate enrollment under the group health plan may subject themselves to a penalty of up to $5,000 for each violation.

As a result, payments to employees on Medicare could be seen as an incentive and would therefore be unlawful. An alternative is for the employer to provide a "cash-out" option for those employees who decline health coverage. A cash-out option allows employees who waive coverage under the employer's plan to receive cash in an amount decided by the employer on a taxable basis in lieu of non-taxable benefits (health insurance). If this option is chosen, it would need to be available for all employees who opt out, not just the Medicare eligible employees.

The cash-out option should be given inside of a cafeteria plan and written into the Section 125 Cafeteria Plan document. The proposed Treasury Regulations state that a Section 125 plan is the only way to offer an employee a choice between cash and benefits coverage without imputed income being applied. If the choice is given outside of a 125 plan, no matter what choice is selected, all employees would be taxed on the cash amount that they could have chosen.

To summarize, an employer with 20 or more employees cannot take into account or incentivize an employee or spouse's entitlement to Medicare, but if a cash-out option is offered to all employees through a cafeteria plan, then the incentive would be permissible.

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Rules of Engagement: Participants Benefit from Investment Advice

A recent study conducted by Charles Schwab Retirement Plan Services indicates that professional investment advice has a profound impact on engaging plan participants. The study shows that 70 percent of participants who receive 401(k) investment advice make changes to their deferral rates and their savings rates nearly double as a result, increasing on average from 5 percent to 10 percent of pay. Also, the study shows that participants who receive professional advice are more properly diversified and have more confidence in their portfolio during times of volatility.

Some other findings include:

- When free personalized advice is available through their employer, 55 percent of plan participants surveyed said they would use it.
- 70 percent of survey respondents indicate that their 401(k) plan is their primary source of retirement savings.
- 51 percent of respondents say they prefer a personal touch over online advice tools.
- 53 percent say they find retirement benefits even more confusing than their health care benefits.
- 65 percent say they need some kind of motivation to use advice.
- 74 percent say they trust personal financial advisers.

The survey covered 755,000 401(k) participants from 911 plans and was conducted by independent research firm Koski Research. If you are interested in engaging more participants through the incorporation of professional investment advice, please contact your plan consultant.

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