
Converting Unused Vacation Days to Retiree Medical Benefits: A Proposed Partial Solution to an Emerging National Crisis

by Donald R. Saxon

Costs for retiree medical benefits are spiraling upward. One way to help fund this area of compensation, with little or no additional financial burden to either employers or employees, could be using an employee benefit plan whereby each year's unused vacation days and sick days are transferred into an employee's tax-free account in a voluntary employee benefit association (VEBA) trust. On retirement, the account is used to purchase a (pre-Medicare) retiree medical plan, prescription drug benefit, a Medicare supplemental policy and/or simply make Medicare premium payments.

The Problem

America faces a health care dilemma as the cost of health care benefits, which was comparatively stagnant in the '90s, has now escalated and exceeds the national inflation rate.¹ As a result, the number of persons covered by health care insurance has declined and is expected to fall even further.² Increases in health care costs most dramatically affect retirees who must address higher medical

expenses from fixed revenue. Some of the largest cost increases have occurred in the area of prescription drugs,³ which has its greatest effect upon the retiree population.⁴

Higher medical costs tax the resources of consumers, place a significant economic burden on American employers⁵ and increase the prices that consumers must pay for products and services. Health care costs account for \$1,234 of the cost of a vehicle produced by General Motors.⁶

As our population ages, senior citizen and retiree health care benefits become a bigger slice of the health care pie, and increase the industry burden: 44% of the beneficiaries of the big three auto health plans are retirees.⁷ Bethlehem Steel, at this writing, provides health care for 130,000 beneficiaries, 90,000 of whom are retirees.⁸ The cost of retiree benefits directly impacts international trade and American import-export tax policy: The recent tariffs placed upon steel imports were needed by U.S. Steel and other major manufacturers due to the significant liability those companies face for retiree benefits or "legacy costs." U.S. Steel's estimated expenses to provide pension and health benefits to its quarter million retirees and their survivors is \$12 billion.⁹ Bethlehem Steel recently reported that it was seeking concessions on retiree medical benefits in order to make itself more attractive to potential buyers or partners bringing in additional capital.¹⁰ Unfunded retiree medical benefit obligations must be included in corporate financial reporting under FASB 106 and are very unattractive to potential purchasers/partners.¹¹

Current Trend Among Employers

Employers have responded to health care cost increases by requiring insured workers to pay a greater portion of health insurance premiums and health care bills.¹² Moreover, retirees from those companies that do provide retiree benefits will be required to share a greater portion of the financial burden: Today, large employers typically pay more than 50% of the total retiree medical expenses; by year 2031, employer support will shrink to less than 10%.¹³ Employers have some flexibility with nonunion employees among the retiree population. Ford Motor Co. recently informed its 50,000 white-collar retirees and spouses that they must, for the first time, pay a monthly premium for health care coverage as well as higher copays for prescription drugs.¹⁴ Such employers have less flexibility with retired hourly workers whose benefits are protected by union contracts.

The Challenge

If American industry is to provide funding, in part or in whole, for retiree health benefits, it must do so in a manner that does not create a continuing financial burden with unpredictable legacy costs that inhibits the ability of American companies to compete internationally with companies from countries where retiree health benefits are government sponsored. Moreover, the benefits promised must be nonforfeitable. LTV, a bankrupt steel group, had its assets sold at a bankruptcy auction. LTV's pension liabilities were assumed by the Pension Benefit Guaranty

Corporation, but its retirees and their dependents lost their health benefits.¹⁵

The challenge is twofold: (i) Spiraling costs must be addressed¹⁶ and a method of controlling those costs must be established; (ii) funding must be identified to meet those costs. The problem of spiraling costs is not addressed in this article. However, this article does identify a source of

est. Blue-collar and service employees lose 55% of their vacation days.¹⁹

Proposal

This article recommends the use of an employee benefit plan whereby each year's unused vacation days and sick days, which an employee would otherwise lose,

“Almost half of all vacation days are lost. Moreover, the vacation-days-lost statistics for the lowest salaried categories of employees (clerical, sales, blue collar and service) are the highest. Blue-collar and service employees lose 55% of their vacation days.”

untapped funds that, if handled correctly, could help fund retiree medical benefits with little or no additional financial burden to either employers or employees.

A Partial Solution: Applying Unused Vacation Days to Pay for Retiree Health Care Benefits

According to the Bureau of Labor Statistics (BLS), the vast majority of employers in this country provide paid vacations. More specifically, a majority of employers provide at least two weeks' vacation after three years, three weeks of vacation after ten years and four weeks after 15 years.¹⁷ Governmental vacations are typically even more generous.¹⁸

However, a lot of vacation days go unused. The most common approaches listed by BLS for employer handling of unused vacation days are to (i) allow carryover to subsequent years (23%); (ii) cash in unused days (13%); (iii) a combination of carryover and cash-in (10%); and (iv) employees forfeit unused vacation days at the end of the year (49%). Almost half of all vacation days are lost. Moreover, the vacation-days-lost statistics for the lowest salaried categories of employees (clerical, sales, blue collar and service) are the high-

receive in cash or defer to another year, are transferred into that employee's account in a voluntary employee benefit association (VEBA) trust. The account grows tax-free and is then used, upon retirement, to purchase a (pre-Medicare) retiree medical plan, prescription drug benefit, a Medicare supplemental policy and/or simply make Medicare premium payments. Such programs would, in some cases, require modifications of existing employer vacation policies but appear to be viable under existing law. There are a number of issues and opportunities.

Avoiding Constructive Receipt

If an employee has the choice of taking vacation pay in cash rather than in days off and has the additional choice of placing those vacation days into a VEBA or other welfare benefits trust, the employee will be taxed on that income under the doctrine of constructive receipt.²⁰ However, if the employee does not have the option of receiving cash, then there is no constructive receipt under Internal Revenue Code (IRC) §451. Moreover, the vacation day cash equivalent that is contributed to the health benefits VEBA is excludable from the employee's income under IRC §106. This applies even if the medical benefits are paid

during the employee's retirement.²¹ Therefore, if the desired tax results are to be achieved, employer plans converting unused vacation/sick days to health care benefits must not use cash as an option.

Avoiding Legacy Costs

The plan must also be funded currently as a “defined contribution” benefit plan (discussed in more detail below) without future undetermined costs over which the employer has no control. Retiree health care benefits (and active employee health care benefits) have traditionally been “defined benefit” in character. The employer promises to pay a portion or all of the employee retiree health care benefits whatever those costs may be at the time. In the case of a collectively bargained union contract or an employment agreement that does not reserve the right to reduce or eliminate this obligation, the employer is contractually bound to provide the benefit as promised in the union contract, employment agreement or employee handbook.

The IRC §401(h) Option Under Defined Benefit Pension Plans

If the employer also provides a defined benefit pension plan, qualified under IRC §401(a), and if there are assets in the plan in excess of that actuarially determined to be necessary to fund the promised pension benefit at retirement age, then IRC §401(h) permits those excess funds to be transferred to a separate account to fund health care benefits during retirement for former employees and their dependents. However, such plans are dependent upon excess funding, which may not be available in a depressed stock market, and lack the predictability of contributions available in a defined contribution plan.²²

The Move to Defined Contribution Health Plans

More recently, however, many employers, frustrated by the increased costs and complexity of defined benefit health care plans, are beginning to use “defined contribution” health care plans for current employees.²³ In a defined contribution health care plan, the employer allocates a fixed amount of cash, annually, for each employee that the employee may then spend for health care and other benefits. For example, an employer may contribute \$10,000 per employee; and each employee

may choose between a no-deductible, no-copayment health care plan costing \$10,000 per year, or a high-deductible plan costing \$5,000 per year along with a dental plan costing \$3,000 per year and a vision plan costing \$2,000 per year. The employee does not have the choice of receiving cash and, therefore, the doctrine of constructive receipt does not apply. Typically, these plans are administered by a third-party administrator and sometimes combined with flex benefit plans (qualified as cafeteria plans under IRC §125) allowing pretax employee contributions.

The defined contribution health plan concept was blessed by the Internal Revenue Service in IRS Notice 002-45 (27 June 2002) and Revenue Ruling 2002-41. The Service characterized these employee accounts as “health reimbursement accounts” (HRAs) indicating that they could either be medical reimbursement accounts, within the meaning of IRC §105(h), or insured plans. The notice and revenue ruling set forth specific guidelines for HRAs, the coordination of HRAs with flex spending accounts, including the application of COBRA continuation requirements²⁴ and HIPAA portability requirements.²⁵ Most significantly, the notice and ruling specifically authorize the employee to carry over to future years any portion of the employers’ contribution which is not used in the year of contribution²⁶ and (pertinent to the discussion here) specifically indicate that the contributions can be used to fund retiree health care benefits. The ruling and notice do not address the possible use of a VEBA to hold contributions for current or retired employees. Nor does the ruling or notice address the applicability of IRC §§419 and 419A (discussed below) to the funds carried forward.

VEBAs and the IRC §419/419A Problem

VEBAs are tax-exempt organizations under IRC §501(c)(9), which can accumulate, tax-free, income-producing reserves for the payment of life, sickness, accident and similar benefits. Although VEBAs achieved tax-exempt status initially as associations formed and funded by employees, changes in the law now permit such associations to be funded by employers as well as employees.²⁷ VEBA trusts are excellent employee benefit vehicles, authorized to provide an extraordi-

nary range of benefits including, as pertinent to this article, vacation pay, sick pay, holiday pay and health care benefits, both during working years and retirement.²⁸

Unfortunately, although retiree medical coverage is an allowable VEBA benefit, VEBAs and other employer-funded welfare benefit plans have not been effective vehicles to fund retiree medical benefits. That is because IRC §§419 and 419A limit the deductibility of current employer contributions to that amount necessary to fund the benefits payable during the year of contribution (“qualified direct cost”), plus actuarially determined contributions sufficient to pay for retirement benefits based upon level contributions over the working lives of the employees using current medical costs (“qualified asset account”).²⁹ The purpose of these limitations is to prevent employers from taking premature deductions for expenses that have not yet been incurred, thus allowing excessive tax-free accumulation of funds.³⁰ These limitations do not apply to collectively bargained union agreements.³¹ Excess contributions (employer contributions in excess of that which is allowable/deductible) are deductible during the next taxable year.³² However, that could cause contributions for that year to be excessive.

Vacation/Sick Day Deferrals and IRC §§419/419A

Based upon IRS ruling history, deferrals of unused vacation and sick days into a retiree health care benefit trust would be considered employer contributions. Private Letter Ruling (PLR) 9635002 addressed a company with a qualified defined contribution pension plan and a vacation policy that required use or forfeiture of vacation days. However, employees who did not use all of their paid vacation days during the year could elect to have some or all of the vacation pay, in

excess of two weeks, converted to cash pay equivalent and contributed to the qualified plan by the company on the employee’s behalf. Employee receipt of cash was not an option. IRS characterized the deferral as a nonelective employer contribution to a qualified plan and ruled that the deferrals were not taxable to the employee nor subject to payroll taxes.

PLR 200222019 allowed conversion of accumulated sick days into a health care benefit plan with the conversion nontaxable to the employees. Once again the deferrals were characterized as nonelective employer contributions. Because deferrals from vacation days to retiree health care benefits in the form of contributions to employee VEBA accounts would be considered employer contributions, the IRC §§419/419A limitations must be addressed.

§§419 and 419A were enacted when virtually all health benefit plans were defined benefit in character—before the advent of defined contribution health benefit plans. The drafters of these sections do not appear to have contemplated the concept of employees deferring the cash value of other benefits into welfare benefit trusts to meet the obligations of retirement health costs. Part of the Deficit Reduction Act of 1984,³³ §§419 and 419A were a response to certain perceived abuses by employers. Anecdotal evidence of allowable current deductions for the full cost of ski chalets and yachts purchased through VEBAs, when a direct purchase would permit only deductions over the useful life of these properties, generated the ire of Congress.³⁴

In the welfare benefit arena, Congress was concerned that the combination of advance deductions for contributions and the availability of tax exemptions for VEBAs would provide tax treatment very similar to that provided to qualified pension

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plans, but with far fewer restrictive provisions.³⁵ Employers were allowed deductions for contributions to welfare benefit trusts before the benefits were actually provided to employees. The example used in the “Reasons for Change” section of the Ways and Means Committee Report demonstrated congressional concern that employers could make significant tax-deductible contributions to VEBAs and the lower compensated employees would receive only insubstantial benefits. The House conferees also expressed concern that employers could make deductible contributions in earlier years that could be applied toward a contribution requirement in later years, or re-funded to the employer.³⁶

The result was the general approach that employers should not be permitted a current deduction for welfare benefits that may be provided in the future.³⁷ The slightly broader provision of the enacted legislation allows deductions for the qualified cost of the plan for the year of con-

tributions and the qualified asset account, which includes funding of medical benefits for retirees no more rapidly than on a level basis over the working life of the employee, based upon current medical costs.³⁸ Thus, VEBAs and advance contributions to VEBAs were severely limited as a viable vehicle to fund retiree health benefit plans.³⁹

Why §§419 and 419A Do Not Apply to Conversion Plans

Based upon the legislative history and the concerns Congress sought to address, §§419 and 419A and the limitations upon contributions thereunder bear no relevance to the defined contribution deferrals of vacation/sick days to VEBAs. IRC §§419/419A were enacted to preclude abuses in defined benefit health plans. In a defined contribution plan where employees are allowed to allocate unused vacation/sick pay to individual accounts in a VEBA trust that cannot be used for other purposes, there is no risk of high-income individuals

accumulating excessive tax-free benefits at the expense of lower income individuals. The VEBA or intermediary organization holds the assets, but those assets are irrevocably dedicated to individual accounts for each of the employee participants.

Contrary to congressional concern, employers cannot take premature deductions for expenses that have not yet been incurred. The payments would have been deductible anyway in the form of compensation/vacation benefits. Employers are obtaining no greater deductions than those employers would otherwise have had. Moreover, there is no risk of these contributions being applied against later employer funding obligations as the employer has no obligation to provide retirement benefits and, as with all defined contribution plans, the balance of the account at the time of retirement is all to which the employee is entitled. The defined benefit actuarial concepts discussed in the statute and legislative history are simply not applicable.

Nor is there a risk of later employer withdrawal. The funds are in individual accounts, ERISA rules concerning fiduciary conduct apply and independent trustees are recommended. House conferees expressed some concern that the lack of clear standards or limitations may allow funds in these accounts to be used for nonqualified purposes.⁴⁰ However, funds in individual accounts held by VEBA trust independent trustees are not likely to be diverted. Moreover, the standards will be clear in the governing document: The individual account assets can only be used to fund retiree health care benefits for that individual and his or her dependents.

General Signal Corporation v. CIR,⁴¹ which addressed contested VEBA deductions for retiree health care, and PLR 9334002, which addressed retiree health care benefit contributions, establishment of reserve for retiree benefits and actuarial computations, both ruled against the employer/taxpayers. However, in neither case did the employer establish a genuine reserve exclusively for retiree medical benefits. The plan recommended here would include individual accounts that could be used only for retirement health care benefits; the reserve requirement would be met. Although both the ruling and the case also discuss the lack of actuarial certification, actuarial certification would not be relevant to a defined contribution plan.

Moreover, both PLR 9334002 and *General Signal* predate Rev. Rul. 2002-41 and Notice 2002-45, in which IRS approved the defined contribution health plan concept and specifically authorized (i) carry-forward of contributed, but unused funds for future years and (ii) funding of retiree benefits with those contributed funds. Neither Rev. Rul. 2002-41 nor Notice 2002-45 mention IRC §§419 or 419A.⁴²

Alternatively, the Deductions Are Available Because §§419/419A Apply

In the alternative, an argument can be made that §419 authorizes the deductibility of deferrals from vacation/sick days to retiree medical benefits: §419 addresses the treatment of funded welfare benefit plans and provides (in typically arcane Internal Revenue Code language) that contributions to a welfare benefit fund are not deductible; but if they would

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otherwise be deductible, they are deductible under §419 for the taxable year in which paid. The definition of *welfare benefits* in a welfare benefit plan at ERISA §3(1) includes “vacation benefits” and “benefits in the event of sickness.” The payments would otherwise be deductible as payment for vacation/sick day benefits and are paid for such benefits available to the employees in the year paid. They are, therefore, qualified costs for the taxable year within the meaning of IRC §419(c). We do not reach the limitations imposed by IRC §419A.

Limitations Upon Contributions

Arguably there should be no dollar or percentage limitation upon contributions. The deferral source, unused vacation/sick days, is inherently limited. Moreover, most employers would require use of some vacation days in traditional vacation use: time away from employment. The 1984 House conferees suggested that postretirement medical benefits are to be taken into account in applying the limitations on contributions and benefits under IRC §415.⁴³ However, in neither PLR 9635002, which involved conversion of unused vacation days to pension plan contributions, nor PLR 200222019, which addresses the conversion of accumulated sick pay to retirement benefits, are IRC §415 limits discussed.

IRC §419A(d) indicates that IRC §415 limits apply to key employees unless a separate account is established for medical benefits with respect to such employees after retirement, and benefits are provided to that beneficiary only from that separate account. In this case, separate accounts are established for all employ-

ees, both key and non-key. Therefore, it does not appear that §415 limits apply.

Scope of Proposed Benefit Package

Although the VEBA can provide for a variety of benefits with funds deferred or contributed to it, it is recommended that this VEBA be limited to providing only postretirement health care benefits and specifically so labeling the individual employee accounts in the trust so as to counter any accusation or suggestion that the funds might be used for any other reason. Although the proposal contained in this article contemplates the use of account funds to purchase insured health care products, the accounts could be used as a medical reimbursement plan, directly reimbursing participants for incurred expenses, if the plan satisfies the nondiscrimination requirements of IRC §105(h).⁴⁴

Growth Benefits

As a funded IRC §501(c)(9) trust, the vacation day and sick day funds converted into the VEBA will grow tax-free, creating a greater source of funds in each individual’s account to pay for benefits upon retirement. Even though participation in VEBAs must be “voluntary,” participation will be considered voluntary even if required of all employees as long as the employees do not incur a detriment such as mandatory dues deducted from pay.⁴⁵

Once employees are VEBA members, unused sick leave pay and vacation pay may be transferred into accounts established for each of the employee participants to provide health care benefits upon retirement. Alternatively, if the employer is already using a VEBA for fund-

ing sick day and vacation day benefits, the funds would simply be allocated from the general fund into the individual employee accounts. Contributions by the employers were already deductible in the form of sick pay and vacation pay as ordinary and necessary expenses of a trade or business under IRC §162(a). IRC §§419 and 419A notwithstanding, there is no reason to believe conversion to retiree health care benefits will alter that treat-

will be funded into the employee's VEBA account.

3. The employer establishes a VEBA with governance provided by representatives of the employees, the corporate sponsor and an independent trustee, all of whom are fiduciaries under ERISA⁴⁷ and have the authority to control and manage the operation and administration of the VEBA.⁴⁸

of vacation and sick leave days will be deductible to the employer, non-deductible to the employee and not subject to payroll taxes.

6. Each participating employee will have a separate account within the VEBA into which the cash value of sick day and vacation day pay will be contributed. The employee will receive an annual statement of contributions, earnings and balances, as required by ERISA.⁵¹
7. The VEBA will offer solely retirement medical benefits. The VEBA beneficiaries would be the employee members/account holders, spouses and dependents as defined in the VEBA regulations. Benefits at retirement could include a pre-Medicare-eligible health plan, payments of COBRA premiums,⁵² a prescription drug benefit plan, a Medicare supplemental insurance plan or direct payments of Medicare premiums. The VEBA could also offer benefits in the form of direct medical reimbursements if the plan meets the nondiscrimination tests of IRC §105(h). Distributions to pay for these benefits would be nontaxable to the employee/participant and his or her dependents.
8. Upon the employee's death, health care benefits would continue for the employee's spouse and other dependents⁵³ until the VEBA account balance was exhausted. Each member would complete a beneficiary designation that would provide for distributions of the remaining account balance upon the later of the death of the employee or spouse; or, if the spouse no longer needs the benefits provided under the plan. Distribution of cash would be subject to income tax. If cash distribution occurred upon the employee's death, the distribution would appear to be taxable as income in respect of a decedent under IRC §691.

“ . . . as long as the employees do not have the opportunity to receive the benefits in cash, the benefits converted will not be taxable to the employees.”

ment. Moreover, as long as the employees do not have the opportunity to receive the benefits in cash, the benefits converted will not be taxable to the employees. As VEBA trust income is nontaxable under IRC §501(c)(9), the accounts will have the opportunity to grow and compound between the years of conversion and retirement.⁴⁶

Recommended Plan

The proposed plan requires the establishment of a welfare benefits VEBA trust and a complimentary corporate vacation policy as listed below:

1. The company adopts a vacation policy requiring all employees to take two weeks' vacation. However, any vacation time in excess of two weeks may be (i) taken as vacation days, (ii) contributed to the company-sponsored VEBA (or if already in the VEBA as vacation benefits, transferred into an intra-VEBA account for the benefit of the employee) or (iii) forfeited.
2. The company adopts a sick leave policy that the cash value of any unused sick days at the end of the year

4. Participation in the VEBA would be mandatory for all who meet the eligibility requirements, but would require no employee contributions and would therefore be “voluntary” within the meaning of §501(c)(9). Eligibility for the VEBA would include all full-time employees with three years of service who are at least 21 years of age.⁴⁹ Employees who do not meet those requirements are excludable under the nondiscrimination rules at Internal Revenue Code §505. Their exclusion makes sense: Most employees do not have more than two weeks' vacation prior to three years of service with the employer, and the vast majority with three years of service are beyond age 21. Most part-time or seasonal employees have very limited sick leave and vacation benefits.
5. The VEBA would be a qualified, tax-exempt IRC §501(c)(9) trust, subject to ERISA reporting and disclosure requirements, including the filing of annual Forms 5500 and the distribution of summary plan descriptions and summary annual reports to the employees.⁵⁰ Deferrals

Sample Applications: The Acme Widget VEBA Plan

The Plan

The Acme Widget Company of Erehwon, New Hampshire (Acme) establishes a VEBA, requiring participation of all em-

employees who have attained age 21 and have at least three years of service. Each employee has an individual account within the VEBA trust. Acme's vacation policy allows for two weeks per year up to three years of service, with three weeks' vacation after three years, and four weeks' vacation after ten years. Each employee who rates three weeks of vacation must take at least two weeks of the three as vacation. The additional week (or additional two weeks after ten years) or any portion thereof, may be taken as vacation, may be lost or the dollar value thereof may be paid into the employee's VEBA account. Each employee also rates five days per year sick leave. Any sick leave not used would be automatically contributed to the employee's VEBA account.

Acme VEBA account funds may be used at retirement or upon disability to pay COBRA premiums, health care premiums, prescription drug benefits, Medicare supplemental insurance, Medicare premiums or any other health care benefit during retirement. The plan defines *early retirement* as a minimum of age 55 and *normal retirement* at age 65. Employees continuing to work beyond normal retirement age may begin using account funds whenever they commence actual retirement.

First Example: Jane

Jane Schmucketella, age 45, has been employed by the Acme Widget Company for three years, rates three weeks' vacation per year and automatically becomes a member of the Acme Widget Company VEBA commencing 1 January 2002. As Jane approaches the end of the year, she has used two weeks of vacation and has not used the third week. Now that Jane is 45, she begins thinking about retirement and payment for medical coverage during retirement. She elects for the funds representing five days of vacation to be funded into her VEBA account. Jane earns \$100 a day and we will assume for simplicity purposes that her salary does not change. The value of vacation days contributed into her VEBA account each year is \$500. She also defers two sick days per year (\$200) into her VEBA account.

Assuming Jane worked for 20 years (until age 65) and deferred one week of vacation time each year (including those years when she was eligible for four weeks' vacation) as well as two days' sick leave

each year, and also assuming a 5% growth rate, the funds available when she retired at the age of 65 to be used for the purchase of retiree medical benefits would be \$26,161. Jane would be eligible for Medicare upon retirement. Jane can use her VEBA account to purchase a Medicare supplemental policy, Medicomp, offered by Anthem BCBS (assuming group policy), for \$262.32 per month. The VEBA account will provide the supplemental policy for 10.8 years. Jane will not be taxable upon the distributions from the VEBA to pay for these medical benefits.

Second Example: Horace

Jane's cousin, Horace Schmucketella, also works for the Acme Widget Company and earns the same salary. He begins contributing at the age of 35 but is only able to contribute three days' worth of vacation and two sick days per year for a total annual deferral of \$500. However, after ten years he is promoted and earns \$150 per day for a total annual deferral of \$750. He continues to defer the same number of vacation and sick days at the increased rate of pay for another 15 years for a total of 25 years of deferrals. He takes early retirement at the age of 60; he is not disabled. Horace would have \$32,415 available to pay for COBRA continuation coverage for 18 months; the remaining balance could be applied toward the purchase of an individual policy until he reached 65 and became eligible for Medicare. Alternatively, if Horace continued to participate in the plan as a member of a retiree group, until age 65, the premium for Horace and his wife would be \$631. The funds in his VEBA account would cover the premiums for Horace until he reached 65 and became eligible for Medicare.

If Horace is covered by his wife Petunia's medical plan when he retires so he does not begin withdrawing until age 65, the funds then available, \$41,371, would cover Medicare payments for both him and his wife, Medicomp payments and a dental policy for almost ten years. None of the payments for any of these benefits would be taxable to Horace.

Variations on the Theme

There are various options some companies may find desirable that would provide the same retirement benefits with

modifications based upon their own vacation benefit design. For example, an employer could provide 15 days of vacation per year, require the employee to take eight days per year and allow the remaining seven days or any portion thereof to be used as vacation, rolled over to the following year or funded into a VEBA retirement health benefits account. Sick days could be reimbursable in cash up to two days per year, with the cash value of any sick days not used beyond two to be funded into the employee's VEBA account. A number of employers now provide "personal days" in lieu of sick days or other days in which compensation is provided, but attendance is excused. Assuming that conversion to cash is not an available option, there is no reason to believe that deferral of the value of these days to VEBA accounts would not be excludible to the employee and deductible to the employer.

Another variation on the deferral would be an employer match similar to those found in many IRC §401(k) plans. For example, the Acme Widget Company in the examples provided above could agree to provide a 10% match on annual vacation day/sick day deferrals. The employer match would come slightly closer to employer engagement in those activities that prompted the enactment of IRC §§419 and 419A. Nonetheless, the match would likely sustain such challenge. However, the plan would no longer have the selling point of paying for itself, as discussed below.

A third, very aggressive option would be to include unused flex benefit deferrals. Currently, flex benefit plans under IRC §125 require the employee to use any salary deferred during the year of deferral or the funds deferred are lost. Instead of losing those §125 deferrals, the funds could be placed into the employee's VEBA retirement health care account, further enhancing the assets available for the purchase of medical benefits at retirement. This option is, however, a stretch. Although the doctrine of constructive receipt would not apply because the employee does not have the option of receiving cash, allowing unused flex benefit deferrals to be carried over to a different benefit exceeds the scope of IRC §125 and may disqualify the §125 plan. Although HRAs under Notice 2002-45 and Rev. Rul. 2002-41 allow carry for-

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ward of employer contributions, the notice and revenue ruling do not authorize carry forward of employee deferrals. Regulatory or perhaps even statutory change would be necessary.

What's in It for the Employer?

While many employers might want to institute such a vacation/sick-leave-to-health care benefit conversion plan for employee retention purposes, these plans would be even more desirable if there was specific financial benefit accruing to the employer. That benefit comes in the form of reduced payroll costs and retiree health care benefit costs. Cash paid in lieu of vacation days or vacation days taken (for which pay is received) are wages within the meaning of IRC §3121. However, employer contributions to and payments by a VEBA for life, sick and accidental benefits are generally exempt from Federal Insurance Contribution Act (FICA) taxes and Federal Unemployment Tax Act (FUTA) taxes. This would include any amount paid by an employer for insurance or paid into a fund to pay for insurance premiums.⁵⁴

Particularly with a large employer, the employer portion of the employment tax saved would well exceed the cost of implementing the plan and reduce the employer's overall payroll costs.⁵⁵ As with any defined contribution plan, an employer sponsoring a conversion of vacation days/sick days to retiree health care benefits has no continuing liability and no balance sheet detriment.

Defined benefit retiree health obligations represent continuing balance sheet burdens; the anticipated liability for these plans must be disclosed under

FASB 106. Currently the trend is to shrink or eliminate employer responsibility for retirement health benefits. Increasing numbers of employers have eliminated retiree health plans altogether for new employees.⁵⁶ IRC 401(k) plans allow employees to provide for their own retirement through salary deferrals; vacation-days-to-retiree-medical-benefits-conversion VEBAs allow employees to partially fund the costs of their own retirement health care expenses.

Conclusion

Vacations are important. As employers we need to encourage our employees to utilize their vacation opportunities, particularly those paid vacation opportunities provided by most employers. It is not the purpose of this article to discourage vacation utilization. However, if employees are not going to use all of their vacation days (and statistically they do not), then such nonuse provides a source of funding for retiree benefits that will be deductible to the employer upon contribution, not subject to payroll taxes, nontaxable to the employee upon contribution to the VEBA, allowed to grow tax-free in the IRC 501(c)(9) trust and then nontaxable upon payment of premiums in purchase of the retiree health care benefits. It is a win-win situation.⁵⁷

Vacation days/sick days-to-retirement-health-benefit-conversion VEBAS will not solve the legacy employee benefit liabilities faced by major steel producers and other large employers. However, such VEBAs can, prospectively, address retiree health care needs for the employees of companies of all sizes and reduce or eliminate future legacy liabilities. ♦

Endnotes

1. See Employee Benefit Research Institute Education and Research Fund, *Health and Welfare Benefit Plans: The Pressure Is On F-5* (2002) (indicating that health care premium increases were at 12% per annum in 1988, dipped as low as 0.8% in 1996, but are now up to 13.2% in 2002, while inflation stays very low); see also Peter Landers, “Costs Are Rising Fast in Health Care,” *Wall Street Journal*, Oct. 2, 2002, at D3 (citing a survey by Towers Perrin indicating the cost of health benefit plans at big companies will rise an average of 15% in 2003, notwithstanding only 2% annual inflation); Kelly Spors and Sarah Lueck, “More People Lack Health Insurance,” *Wall Street Journal*, Sept. 30, 2002, at A1 (noting that employees' cost for group insurance more than doubled from 1989 to 1999); Bill Brubaker, “Health Premiums Continue to Rise,” *Washington Post*, May 16, 2002, at E1; Reed Abelson, “Hard Decisions for Employers as Costs Soar in Health Care,” *New York Times*, Apr. 18, 2002, at C1; Julie Appleby, “California HMO Costs Soar 25%; Trend May Spread,” *USA Today*, Apr. 18, 2002, at B3.

2. See Spors and Lueck, *supra*, at A1. What once was a poverty-level problem has now become a middle class problem with large numbers of middle class persons not covered by health plans. John M. Broder, “Problem of Lost Health Benefits Is Reaching Into the Middle Class,” *New York Times*, Nov. 25, 2001, at A1.

3. See Thomas M. Burton, “Left on the Shelf: Why Cheap Drugs That Appear to Halt Fatal Sepsis Go Unused,” *Wall Street Journal*, May 17, 2002, at A1; Scott Hensley, “Bleeding Cash: Pfizer ‘Youth Pill’ Ate Up \$71 Million Before It Flopped,” *Wall Street Journal*, May 2, 2002, at A1; Ann Zimmerman and David Armstrong, “Swallow This: How Drug Makers Use Pharmacies to Push Pricey Pills,” *Wall Street Journal*, May 1, 2002, at A1; Gardiner Harris, “Dose of Trouble: For Drug Makers, Good Times Yield to a New Profit Crunch,” *Wall Street Journal*, Apr. 18, 2002, at A1. One method currently being attempted to reduce drug costs is the formation of a nonprofit organization by nine states and the District of Columbia that will manage prescription plans and try to hold down spending on medicines for governmental employees. New York, one of the nine states involved, spent \$2.4 billion on prescription drugs for more than three million Medicaid recipients in 2002, which is 7.5% of all its Medicaid spending and an increase of 75% from 1998. All nine states are facing budget deficits and are using this organization to maximize the drug benefits they can provide. See Milt Freudenheim, “States Organizing a NonProfit Group to Cut Drug Costs,” *Wall Street Journal*, Jan. 14, 2003 at A1.

4. See Sarah Lueck and Stephanie Horvath, “Prices of Prescription Drugs Used by Seniors Soared in 2001,” *Wall Street Journal*, June 25, 2002, at D3. In an effort to combat the problem of rising health care prescription drug costs for the elderly, both Republicans and Democrats have proposed prescription drug benefit plans. See Medicare Modernization and Prescription Drug Act of 2002, HR 4954, 107th Cong. (2002); Medicare Rx Drug Benefit and Discount Act of 2002, HR 5019, 107th Cong. (2002).

5. See Watson Wyatt, *Health Care Costs 2002—Watson Wyatt Worldwide Survey Results* (visited Sept. 24, 2002) www.watsonwyatt.com/research/printable.asp?id=ONL002 (reporting that, based on a worldwide survey, employers' health care plan costs increased by 13.6% in 2002; costs for indemnity plans increased by 14.4%; and costs for HMOs increased by 13.9%). Sharing of those costs, as between employers and union groups, has become a battleground as costs increase and employers seek to pass on some or all of those increases to employees. It is anticipated that

health care costs will be one of the primary issues when the big three automakers negotiate new contracts with UAW in fall 2003. See Bernard Wosocki Jr., "Unions Gird or Battle Over Medical Bills," *Wall Street Journal*, Nov. 4, 2002 at C1.

6. Telephone interview with Jennifer Knightstep, General Motors Corp., in Detroit, Mich. (Sept. 25, 2002). However, this figure seems low since in 1992, it was reported that health care costs accounted for \$1,086 of the cost of an average vehicle made by the big three U.S. automakers. See Technology Brief: "Health-Care Costs Add \$1,086 to U.S. Car Prices," *Wall Street Journal*, Feb. 6, 1992, at B5.

7. *Id.*

8. See *The Future of American Steel: Ensuring the Viability of the Industry and the Health Care and Retirement Security for Workers: Hearing Before the Senate Committee on Health, Education, Labor and Pensions*, 107th Cong. (2002) (statement of Robert S. Miller, chairman of the board and chief executive officer, Bethlehem Steel Corp.). (Mr. Miller's statement can also be found at www.bethsteel.com/policy/pdfs/millertestest.pdf.)

9. See Caroline Daniel, "Instinct to Consolidate Still Strong," *Financial Times Ltd.* (London), July 3, 2002, at 29. These legacy costs also hamper reorganization of the steel industry. See Len Boselovic, "President Bush Said to be Irked by Big Steel's Inactivity," *Pittsburgh Post-Gazette*, July 11, 2002, at E1. As discussed in Boselovic's article, the chairman of U.S. Steel offered to acquire some troubled steel makers and create a company large enough to compete with foreign competitors. However, the offer was conditioned upon modification of the contract with United Steelworkers of America and federal assistance with legacy costs. The legacy costs act as an impediment to the kind of industry reorganization that would make American steel competitive in both the U.S. and the world market.

In addition, the net present value of Bethlehem Steel's legacy benefits, including pensions, is \$3 billion. *Bethlehem Steel Corp., Annual Report 7 (2001)*. In 2001, Bethlehem Steel spent \$268 million on medical insurance and other postemployment benefits. *Id.* at 24.

Only 30% of employers provide medical benefits to retirees and therefore face legacy medical liabilities. See Jeffrey McCracken, "Ford Shifts Health Costs to Retirees," *Detroit Free Press*, April 11, 2002 (Mr. McCracken's article can be found at www.auto.com/industry/ford11_20020411.htm). However, the companies that tend to be large corporations with binding union contracts continue to provide those benefits.

The legacy costs are significant even in those corporations not bound by union contracts. Ford spent \$500 million on white-collar retiree health care and says that it expects that to rise 14% in 2002. Ford spent \$2.4 billion on all health care claims in 2001. With its white-collar retirees, Ford has the option of requiring retirees to pay a portion of that cost or increasing the portion for which the employee is responsible, which Ford did in April of this year.

10. Robert Guy Roberts, "Bethlehem Steel Seeks Concessions on Retiree Benefits," *Wall Street Journal*, July 10, 2002, at A2.

11. Financial Accounting Standards Board, Statements of Financial Accounting Standards No. 106, Employer's Accounting for Postretirement Benefits Other Than Pensions, December 1990.

12. See Peter Landers, "Costs Are Rising Fast in Health Care," *Wall Street Journal*, Oct. 2, 2002, at D3 (citing a Towers Perrin survey that indicated employees will pay, on average, \$48 per month for health care coverage in 2003, which is up from \$38 per month in 2002); see also Spors and Lueck, *supra*, at A1 (indicating that the cost employees pay for group health insurance more than doubled between 1988 and 1999); Peter Landers, "Insured Workers

Are Paying More of Health Bills," *Wall Street Journal*, Sept. 6, 2002, at B5.

13. Watson Wyatt Worldwide, *Retiree Health Benefits: Time to Resuscitate?* (visited Sept. 24, 2002) www.watsonwyatt.com/research/printable.asp?id=ww-559.

14. McCracken, *supra*. General Motors is also having similar problems. General Motors still provides retiree health benefits for all union workers and nonunion workers who began employment prior to 1993. However, the portion of premiums to be paid by both active and retired workers continues to increase. Even with increased premiums paid by retirees, retiree health benefits still now cost GM about \$3 billion. See Jeffrey Zaslow and Gregory L. White, "For GM Retirees, It Feels Less Like 'General Motors,'" *Wall Street Journal*, Feb. 21, 2003, p. A1.

15. Boselovic, *supra* at E1.

16. Both major political parties in both Houses of Congress have initiated bills to address prescription drug benefits for senior citizens. See Medicare Modernization and Prescription Drug Act of 2002, HR 4954, 107th Cong. (2002); Medicare Prescription Drug Coverage Act of 2001, S 10, 107th Cong. (2001). However, the bills only address Medicare recipients, not the retirees short of Medicare eligibility; and even if any of these bills were enacted, there would be additional costs required for participation. Moreover, the bills have been subject to criticism. See Amy McConnell, *GOP Prescription Plan Protested Locally* (visited July 3, 2002) www.concordmonitor.com/stories/front2002/localrxagain_2002.shtml.

17. See Bureau of Labor Statistics, U.S. Dept. of Labor, *Employee Benefits in Medium and Large Private Establishments, 1997 18* (1999). Furthermore, paid sick leave is available to over half (53%) of all employees in private industry. Bureau of Labor Statistics, U.S. Dept. of Labor, *Employee Benefits in Private Industry, 1999, 5* (2001).

18. Bureau of Labor Statistics, U.S. Dept. of Labor, *Employee Benefits in State and Local Governments, 1998, 11* (2000).

19. Bureau of Labor Statistics, U.S. Dept. of Labor, *Employee Benefits in Medium and Large Private Establishments, 1997 18* (1999). Please note that this information comes only from medium to large employers who employ at least 100 employees. However, anecdotal information indicates that similar numbers can be found with smaller employers as well.

20. See IRC §451; see also Treas. Reg. §1.451-2 (as amended in 1979); Rev. Rul. 75-539, 1975-2 C.B. 45.

21. See Rev. Rul. 75-539, 1975-2 C.B. 45.

22. The Internal Revenue Code provides that once all of the liabilities under the plan to provide medical benefits are satisfied, any amount remaining in the account must be returned to the employer. See IRC §401(h)(5). Employees would be less inclined to convert vacation/sick days to retiree health care benefits if refund to the employer was a possibility.

Moreover, a 401(h) plan is normally provided in conjunction with defined benefit pension plans, which are in decline. In 1993, 63% of all pension plans were defined benefit in character while only 45% were defined contribution plans. By 1997, 57% of all retirement plans were defined contribution. See Bureau of Labor Statistics, U.S. Dept. of Labor, *Employee Benefits Survey, Incidence of Defined Benefit Pension Medium and Large Private Establishments* (visited July 2, 2002) data.bls.gov/cgi-bin/surveymost.

Certainly the significant growth of IRC §401(k) plans and SIMPLE IRA plans account for a large percentage of this shift. See Employee Benefit Research Institute, *Defined Contribution Plan Dominance Grows Across Sectors and Employer Sizes, While Mega Defined Benefit Plans Remain Strong: Where We Are and Where We Are Going*, Issue Brief no. 190 (1997).

Transfer of vacation or sick day benefits from an employer, from a VEBA or perhaps directly to a

401(h) plan may be considered to be an inurement of net earnings to the benefit of the employer and therefore possibly considered income to the employer under IRC §4976 and the "tax benefit rule." See Gen. Couns. Mem. 39,785 (May 18, 2002).

23. See Watson Wyatt, *Health Care Costs 2002—Watson Wyatt Worldwide Survey Results* (visited Sept. 24, 2002) www.watsonwyatt.com/research/printable.asp?id=ONL002 (reporting that 6% of employers reported that it was "likely" that they would switch to a defined contribution approach within the next 12 months and 14% indicated that it was "somewhat likely" that they would switch to a defined contribution approach within the next 12 months).

24. See Consolidated Omnibus Budget Reconciliation Act (COBRA), Pub. L. No. 99-272 (1986) (codified as amended at I.R.C. §4980B (1986)).

25. See Health Insurance Portability and Accountability Act of 1996 (HIPAA), IRC §9801.

26. This is actually a bit misleading. Most HRAs are unfunded so that at most, the participant carries forward an obligation of the employer to pay for health care benefits. If the employer goes bankrupt, the benefit, even if carried over and multiplied over several years, is lost. Moreover, even though the notice and ruling are hailed as going beyond the "use it or lose it" concept, the benefit could still be lost if the employee changes employment. The employer is not obligated to deliver funds to the employee upon departure from employment or to continue to maintain the account for the employee's benefit. If the employee does not use it he or she loses it. Since the account is unfunded in most cases, there is nothing for an employee to take or roll over to the account of a new employer.

27. See Tax Reform Act of 1969 (enacted).

28. VEBAs can also be used to provide life benefits, either indemnified or self-insured (term only); subsidize recreational activities, such as athletic leagues; provide child-care facilities for preschool and school-age dependents; provide benefits that protect against a contingency that interrupts or impairs a member's earning power such as job readjustment allowances, income maintenance payments, temporary living expenses in the event of disaster, supplemental unemployment compensation; and provide severance benefits and education or training benefits such as apprentice training programs. See Treas. Reg. §1.501(c)(9)-3 (1981).

29. *Id.* at §1.501(c)(9)-3(a) (1981).

30. See H.R. Rep. No. 98-861, at 1155 (1984) reprinted in 1984-3 C.B. 408, 409.

31. See Priv. Ltr. Rul. 93-31-041 (May 10, 1993). In addition, the §419/419A limitations apparently do not apply to contributions to VEBAs to the extent those contributions are intended to fund health benefits for employees who are already retired. *Wells Fargo & Company and Subsidiaries*, 120 TC No. 5 (2003). The statute requires that the actuarial present value of the projected benefit be allocated on a level basis to each year, commencing with the year in which the allocation is first recognized and ending with the year the employee is expected to retire. The court held that the funding of "a reserve funded over the working lives of the covered employees" cannot begin until the reserve is created. If the reserve is not created until after the employee has retired, there are no future years to which the benefits may be allocated and the entire present value of the projected benefit can be allocated to the first year.

32. See IRC §419(d).

33. See Deficit Reduction Act of 1984, Pub. L. No. 98-389 (enacted).

34. See H.R. Rep. No. 98-432, at 1276 (1984) reprinted in 1984 U.S.C.C.A.N. 935, 937.

35. *Id.* at 1275.

36. See H.R. Rep. No. 98-861, at 1155 reprinted in 1984-3 C.B. 408, 409.

37. See H.R. Rep. No. 98-432, at 1276-77 reprinted in U.S.C.C.A.N. 937, 938.

38. See H.R. Rep. No. 98-861, at 1157 reprinted in 1984-3 C.B. 408, 411.

Union plans were exempt from these limitations on the theory that reserves in such plans would not be excessive due to the arm's length negotiations between adversarial parties inherent in the collective bargaining process. *Id.* at 1158.

39. There is an exception to the general limitation for plans involving ten or more employers. See I.R.C. §419A(f)(6). The limitations do not apply to plans consisting of more than ten employers as long as the plans do not maintain experience-rating arrangements for the individual employers. See Prop. Treas. Reg. §1.419A(f)(6)-1(a)(1)(iii) (year). This might work very well for VEBAs as multiemployer VEBAs are authorized under IRC §501(c)(9) as long as there is a commonality among the employers such as industry or geography. Multiemployer VEBAs would be more efficient to operate and better able to obtain beneficial premium rates from insurers and HMOs.

40. See H.R. Rep. No. 98-861, at 1155 reprinted in 1984-3 C.B. 408, 409.

41. *General Signal Corp. v. Commissioner*, 103 T.C. 216 (1994), *aff'd*, 142 F.3d 546 (2d Cir. 1998).

42. The motivation in *General Signal* and in a number of other cases may have been to reduce overall taxation due to a change in the corporate tax rate. However, although the deduction was taken, an account for postretirement benefits was not actually funded. See *Parker-Hannifin Corp. v. Commissioner*, 139 F.3d 1090 (6th Cir. 1998) (finding that no actual funding occurred); see also *Square D Co. v. Commissioner*, 109 T.C. 200 (1997) (holding that no notice of the contributions was given to the employees, retirees or the VEBA auditors, and Field Service Advice 1991-531, No. 656 where there was a failure to identify any assets of the VEBA as intended to provide for payment of postretirement medical benefits as compared to preretirement medical benefits). The proposal contained in this article contemplates separate accounts that can be used only for postretirement benefits and for no other purpose.

43. See H.R. Rep. No. 98-861, at 1157 reprinted in 1984-3 C.B. 408, 411.

44. The Internal Revenue Code precludes discrimination in favor of highly compensated personnel in a self-insured medical expense reimbursement plan. See IRC §105(h). Furthermore, the Code re-

quires that a self-insured medical expense reimbursement plan cover at least 70% of all employees or at least 80% of all employees eligible to participate under the plan if at least 70% of all employees are eligible to participate. *Id.* at §105(h)(3)(A).

45. See Treas. Reg. §1.501(c)(9)-2(c)(2) (1981).

46. The contributions to the VEBA are nontaxable to the employee. See IRC §106. There is specific authority for both conversion of sick days and vacation days to retiree benefits. See Priv. Ltr. Rul. 93-230-06 (March 5, 1993); see also Rev. Rul. 75-539, 1975-2 C.B. 45. Moreover, the contributions will not be subject to payroll taxes. See Priv. Ltr. Rul. 96-350-02 (Nov. 9, 1995); IRC §3121(a)(5)(A).

47. See Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406 (1974) (codified as amended at §401(a)). This would be a welfare benefit plan under ERISA §3(1) and ERISA fiduciary principles would apply.

48. See ERISA §402(a)(1).

49. See IRC §505(b)(2).

50. See ERISA §104.

51. *Id.*

52. There are potential problems in providing these benefits as a group program for company retirees. Some health care insurance providers and HMOs (e.g., Blue Cross and Anthem) will not allow retirees to be covered as part of an overall company plan unless the company remains financially responsible for at least part of the premium payments. Obviously, if the retiree plan can be structured so as to be part of the company's overall health care plan, the premium rates obtainable would be much more favorable than individual retirees using their VEBA account funds to purchase individual policies. It is hoped that the availability of the VEBA account assets as a source to meet premium obligations will meet carrier underwriting requirements so as to allow continued participation of retirees without any additional financial obligation to burden the employer.

53. For VEBA purposes, *dependent* is more broadly defined than for other purposes and includes the member's spouse, any child of the member or child of the member's spouse who is a minor or a student, any other child residing with the member, and any other individual who, based upon information provided, the member believes is a dependent for tax purposes. See Treas. Reg. §1.501(c)(9)-3(a) (1981).

54. See IRC §3121(a)(5)(A); Priv. Ltr. Rul. 96-350-02 (Nov. 9, 1995).

55. Some employers, which have profited as a result of employee forfeiture of vacation days, may see a conversion plan as a detriment and not wish to consider adoption. However, employers' budget for vacation days and the number that will be forfeited is not predictable with scientific accuracy, so it is difficult to determine the number of employers that would refrain from adopting a conversion plan in order to continue profiting from vacation day forfeitures. Correspondingly, employees of those companies that pay cash in lieu of unused vacation days may not want to lose that cash "bonus." Once again, it is difficult to determine the number of employees that would fall within this category.

Another consideration is the effect of sick days taken upon company productivity and, ultimately, bottom-line profit. In 2002 at American Airlines, more than 5% of the workforce was absent on an average day, costing the company more than \$1 million a day. Some companies offer incentives for employees not to take sick days (Stephanie Armour, "Sick Days May Hurt Your Bottom Line," *USA Today*, Feb. 7, 2003, at 1A). While it is not suggested here that employees report for work if genuinely ill, institution of an employee benefit wherein the value of unused sick days are contributed to a VEBA account to provide retiree health care benefits may be a superior and less expensive incentive than paying employees in cash not to take sick days.

56. See Watson Wyatt, *Retiree Health Benefits: Time to Resuscitate?* (visited Sept. 24, 2002) www.watsonwyatt.com/research/printable.asp?id=W-59.

57. It could also provide other benefits such as reducing the growth of health care costs, which benefits employers, employees and the community at large. While somewhat speculative in character, the theory is that if the benefits are actually funded, so that the employee has funds available which can only be used for health care benefit purposes, and he wants those funds to last as long as possible, the employee will be much more careful in expending those funds, thereby reducing health care facility usage and bringing down overall costs. See Employee Benefit Research Institute Education and Research Fund, *Health and Welfare Benefit Plans: The Pressure Is On F-13—F-15* (2002).

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