



Accumulated Leave Payouts:

Lower Your Tax Liability for the District and Employees



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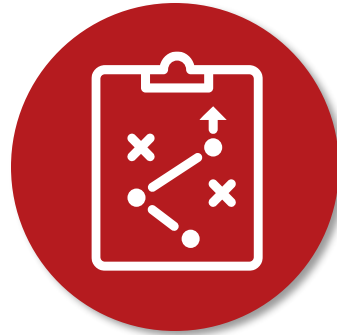
About US

- Focused on reducing the district's costs and advocating for the employees
- Industry leader in the design, implementation and administration of specialized retirement plans for public sector employers and employees
- MSBO partnership experience providing 401(a) plans to Michigan's school districts
- Serving more than 15K employer clients and more than 3.5 million participants across the U.S.
- Serving more than 45% of school districts in the country through USRBP Partner Firms

Today's Objectives



Current Landscape
of Accumulated
Leave in Michigan



3 Ideas for
Lowering Taxes on
Leave Payouts



How it Could
Benefit You and
Your District



Case Study

Accumulated Leave in Michigan:

A Brief Overview of the Current Landscape

Three methods currently used to payout accumulated leave

1. No Formal Structure

- EE's electively defer payout to 403(b) Plan or receive cash
- EE's establish 403(b) account prior to separation

2. Board Policy

- Mandates payouts be directed to a 403(b) established by the EE
- Payments are mandatory & considered an **Employer Contribution**
- EE's establish a 403(b) account prior to separation

3. Special Pay Plan

- Establishes a separate plan for accumulated leave payouts
- Payments are mandatory & considered an **Employer Contribution**
- EE's are automatically enrolled (no account establishment required)
- Employer handles every payout exactly the same
- Can utilize 401(a) for increased amounts (no coordination with 403(b) deferrals)



Idea #1 for Lowering Taxes on Leave Payouts



Special Pay Plan

A glance at how the **Special Pay Plan** works:

Retirement benefit that automatically places unused accumulated leave into a 401(a), 403(b), or 457(b) plan in the participant's name versus a direct cash payout

Employer and Employee permanently avoid Social Security and Medicare Tax and any associated matches on plan contributions

Employees will defer Federal and State Income Tax until funds are withdrawn. Best of all, it's an additional retirement savings vehicle that doesn't impact any elective 403(b) or 457(b) deferral limits

What Contributions Qualify for Special Pay

Unused sick leave & vacation pay

Severance

Retirement Incentives

Contributed upon retirement or separation of service

401(a), 403(b), or 457(b) Special Pay Plan Retirement Account

How a Special Pay Plan Works

Example: Participant with \$20,000 in termination pay.

	Without the Special Pay Plan	With the Special Pay Plan
Accumulated Termination Pay	\$20,000.00	\$20,000.00
Federal Taxes (22%)	\$4,400.00	\$0.00
State Taxes (4.25%)	\$850.00	\$0.00
Social Security (6.2% on \$168,600)	\$1,240.00	\$0.00
Medicare (1.45%)	\$290.00	\$0.00
Total Taxes Paid	\$6,780.00	\$0.00
Employee Benefit	\$13,220.00 Net Pay	\$20,000.00 In Special Pay Plan

FICA and Medicare Taxes are permanently saved: \$1,530.00

State and Federal Taxes are deferred until participant chooses to receive money

Special Pay Plan Design Flexibility

Eligibility



- Any class of employees
- Subject to any Collective Bargaining Agreement

Age



- Any age, or set a specific age (e.g. 55+)

Contribution Amount



- Set minimum (e.g., \$1,000+)

Contribution Timing



- Annual “excess” days in-service payout or at separation from service

Triggering Event



- Retirement or any separation from service

Special Pay Plan 2024 Contribution Limits

401(a)	403(b)	457(b)
<ul style="list-style-type: none">• IRS 415(c)(1)(a) Limit – lesser of \$69,000 or 100% of salary. If plan year salary is less than \$69,000, a different calculation will be used.• Employees can also fully fund their elective deferral 457(b) and 403(b) Plans	<ul style="list-style-type: none">• Same limits as 401(a) Plan - lesser of \$69,000 or 100% of salary• Limit offset by employee elective deferral contributions to 403(b) Plan	<ul style="list-style-type: none">• IRS 415 Limit – lesser of \$23,000 or 100% of salary• \$7,500 Age 50 Catch-up• *FICA and Medicare taxes still apply

Idea #2 for Lowering Taxes on Leave Payouts



Retiree Health Reimbursement Arrangement

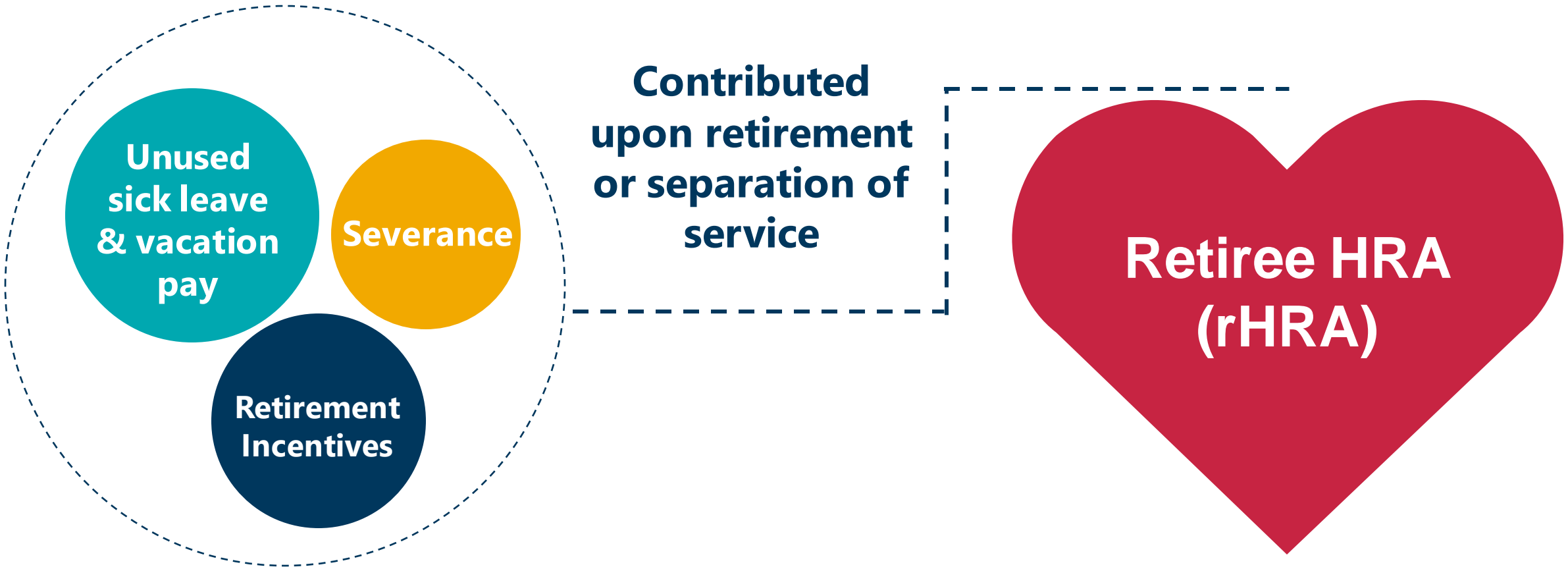
A glance at how the an **rHRA** works:

Used to pay for health care expenses (including insurance premiums) for employee, spouse, and tax dependents

Fully portable and immediately accessible - employees can use rHRA funds for life

Triple tax-free - contributions, earnings and reimbursements are never subject to federal, state or FICA taxes

What Contributions Qualify for an rHRA



Idea #3 for Lowering Taxes on Leave Payouts



Special Pay Plan + rHRA

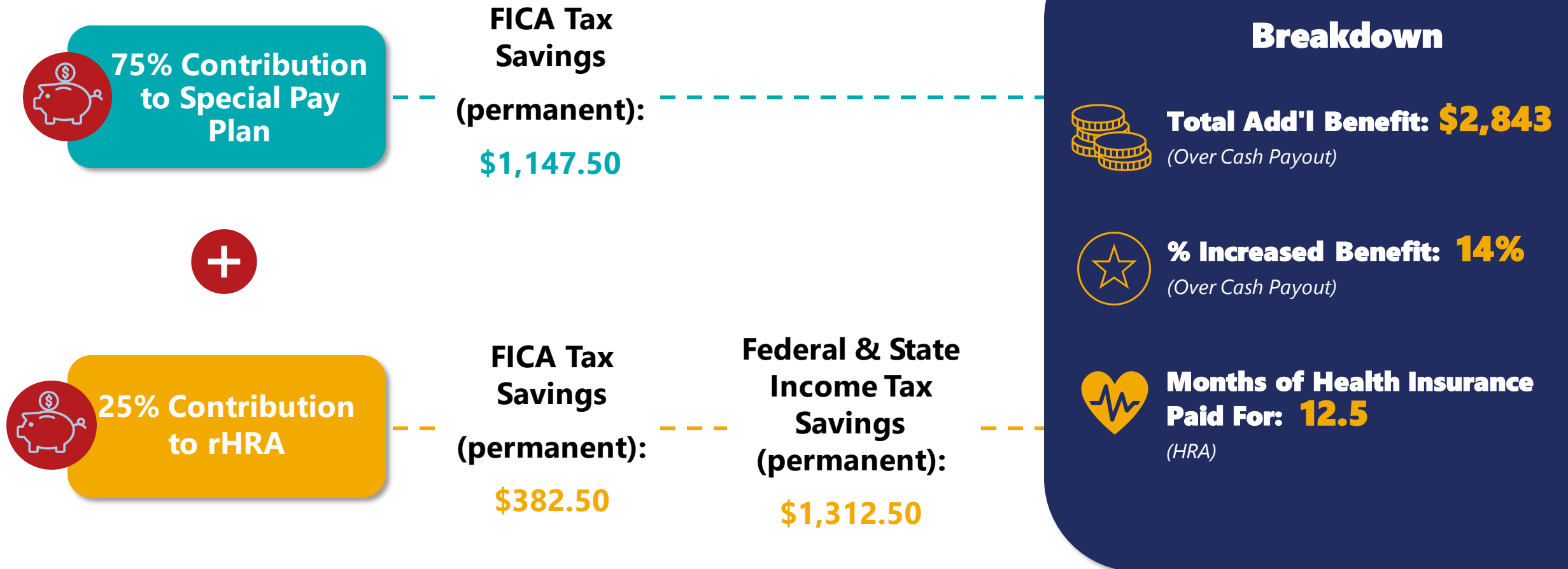
A glance at how the **Special Pay Plan & rHRA** works together:

The Special Pay Plan and rHRA can be combined into one retirement benefit, with percentage allocations of accumulated leave/incentive payouts directed to each plan based on the desires of the employer and/or bargaining group.

Provides the “best of both worlds”—tax-deferred funds that can be used for anything, and tax-free funds to pay for health care. Payouts can even be dollar-capped to keep contributions to a particular plan below a desired threshold.

The Best of Both Worlds

How the Special Pay Plan and rHRA work together



Example: We assume an employee receiving a \$20,000 leave payout at an average annual salary of \$60,000, with an estimated \$400 in monthly health insurance premiums. Note how far a smart plan design can go in maximizing employee benefit value.

Comparison of Benefits

	Cash Payout	Elective Deferral	Special Pay Plan	rHRA	Special Pay Plan & rHRA
Eliminates FICA Taxes			✓	✓	✓
Eliminates Federal Income Taxes				✓	✓
Offsets health care costs				✓	✓
Deferred State and Federal Income Tax		✓	✓		✓
Immediate Access to Cash	✓	✓	✓		✓

Case Study: Chesapeake Public Schools (VA)

Chesapeake Public Schools is a large school system in Virginia serving over 39,000 students, employing almost 5,700 teachers, administrators and other personnel, and representing 45 schools

Payroll Tax Savings



~\$232,000

Payroll tax savings realized during 2022 and 2023 combined



~\$112,000

Payroll tax savings realized by end of Q3 2023 alone

The Opportunity





- Interested in streamlining payroll and retirement processes
- Realized **Special Pay Plan** could also drive tax savings that could be reinvested in the school

The Results

- **Cost Savings**—Savings for both the employer and employee—at the employer level, it allows Chesapeake to reallocate saved funds to cover the costs of other necessary items like buses, building renovations, recruitment and more
- **Process Improvement & Simplification**—Implementing the Special Pay Plan alleviated the burden on the school's payroll/benefit staff while simplifying the employee's transition from employment to retirement

ORS Graph – Retirements by Year

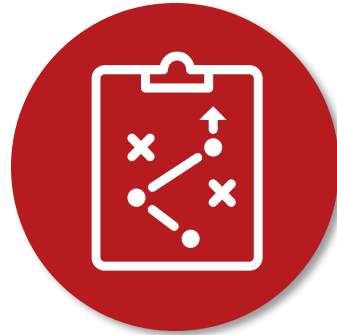
Public School Employee Retirements Beginning to Decline

 MICHIGAN OFFICE OF RETIREMENT SERVICES ORS member retirement data			
Retirements in the year:	 Public school employees	 State employees	 State police officers
2023	6,485	957	91
2022	7,249	1,137	72
2021	7,160	1,286	97
2020	7,101	1,401	197

Today's Takeaways



If your district is paying out accumulated leave in cash, there's a better way



Special Pay
rHRA
Special Pay + rHRA



Avoid FICA taxes for district & EE /
Defer or avoid federal & state income taxes for EE



Now that you see Chesapeake VA savings, what would you do with extra resources?

QUESTIONS?



Scan the QR code to
schedule a meeting!



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