EXPLORING POLICY MODELS FOR EXTENDED TIME OFF

POLICY BRIEF

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Introduction

Whether it's a personal health condition, the birth of a new child, or the need to address a serious health issue of an aging parent, many, if not most workers, find that at certain points in their lives, they will need an extended amount of time off from work. We refer to this as Extended Time Off (EXTO).[1] In addition, there is a growing body of research that outlines the potential benefits of paid time off for workers, their families (and in particular children), as well as some research suggesting a benefit to employers providing paid EXTO.[i] While the U.S. provides 12 weeks of job protected leave under the Family and Medical Leave Act to some workers, this time off from work goes largely unpaid for most workers.

That is not to say, however, that the U.S. lacks any policy levers with which to address the need for paid time off. Indeed, there are a number of recent policy developments at the state level which provide important lessons for policymakers thinking about funding EXTO. There is also a patchwork of national policies and programs which provides some workers with varying levels of wage replacement, under certain conditions. Beyond policy prescriptions, roughly 64 percent of employers voluntarily provide certain types of paid leave (maternity, paternity) for at least some of their employees.[ii]

While there have been past analyses of and proposals for paid leave, and even recent legislative efforts at the federal level, few efforts have laid out the full range of possibilities that might be employed in achieving EXTO. Workplace Flexibility 2010 (WF2010), a research, education and consensus-building enterprise at Georgetown University Law Center, began such an effort in 2003. This Policy Document is rooted in a collaboration with WF2010 over the past year. Building on some early work by WF2010 in 2006,[2] this paper deepens our understanding of the range of policy options, with the aim of continuing the conversation on how we might provide all workers with access to wage replacement during times of extended leave.[3]

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1 The term Extended Time Off (EXTO) was created by Workplace Flexibility 2010 (WF2010) at Georgetown University Law Center. We adopt here WF2010's definition for EXTO: a need for time off from work for a single reason that extends for more than five days but less than one year (e.g., caring for a newborn or newly adopted child, having a serious health condition or caring for a family member with a serious health condition, or serving in the military). See Workplace Flexibility 2010, *Extended Time Off Overview*, November 2006, updated November 2008, available at http://www.law.georgetown.edu/workplaceflexibility2010/definition/exto.cfm

2 In WF2010's document, *Extended Time Off Overview* (2006), policy options for financing EXTO were divided into four categories: employee pays; employer pays; government pays; and joint financing from some combination of employees, employers and government. See *Extended Time Off Overview*, at 17-42.

3 The conversation that WF2010 has been facilitating focuses on both wage replacement during EXTO and job protection during EXTO. See *id.* at 4-10. For purposes of this Policy Brief, however, we are limiting our focus

Box 1: Potential EXTO Models

Social Insurance Models:

- Unemployment Insurance
- Social Security (retirement and disability insurance)
- State Temporary Disability Insurance

Employer-Based Models:

- Leave Banks
- Employer Mandate
- Employer-based Hybrid Models

Individual-Based Models:

- Individual Accounts
- Tax Credits

This paper provides a summary of a longer report where we explore in greater depth the components of several current policies, outlining the challenges and opportunities each program presents in overlaying or integrating paid time off. The ideas draw on extensive background research in numerous policy arenas, as well as interviews with six policy and economic experts from the fields of disability policy, health care, labor and finance, tax and employment.

In total, we examine nine policy options that span a continuum of approaches. We have divided these nine options into three categories that WF2010 asked that we focus on— social insurance models, employer-based models, or individual-based models (see Box 1). Each category is meant to capture different ways to engage the primary actors in an EXTO policy—namely, the government, employers, or workers.

To be sure, each policy option we discuss has a role for each actor, often in the ways programs are financed or administered. Social insurance models have a strong government role in providing a "universal" benefit to workers, with the model driven by some insurance mechanism that pools workers across firms and industries.

The employer-based models deliver or make a program available to employees, though employers might be required to provide the program or benefit. Contrary to the social insurance model, these programs often do not pool across other firms, and the program or benefit is often tied to that particular employee-employer relationship.

Finally, we examine a set of policies using individual-based models, where the program or benefit is neither tied into a government insurance program nor linked to a program or benefit provided through an employer. These policy options often rely heavily on the individual to "own" their own program or benefit, though government, or employers, or both might have a financial role in supporting or incentivizing the worker's paid EXTO.

Again, the goal of this paper is not to provide an exhaustive exploration of each policy model, but rather to give a brief overview of several options to inform the range of possibilities. We acknowledge that developing a paid EXTO policy, though taking cues from existing policies and programs, still needs careful attention to program details and financing in order to ensure

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exclusively on providing wage replacement for family and medical leave needs. Providing this paid benefit does not necessarily also guarantee job protection while the worker is away from work. We acknowledge upfront that job protection is another critical need for workers- and particularly problematic for the 45 percent of workers who lack access to the protections afforded by the Family and Medical Leave Act (FMLA). However, we purposefully separate this policy goal from the issue of providing wage replacement, only acknowledging below when the issue of the de-linking of job protection creates an issue in a paid leave proposal.

successful passage and implementation. In addition, further study is needed to examine the costs and employment effects of any policy proposal to ensure that the program avoids any unintended consequences to workers, employers, and the economy as a whole. Table 1 at the end of this report provides an overview of each mechanism.

Social Insurance Model -- Unemployment Insurance

Overview of the Model. Unemployment insurance (UI) is a social insurance program that provides limited wage replacement for individuals who have lost their jobs. In place since 1935, the program is operated through the states, which tax employers to support most of the program costs and determine the rules that govern the program through state legislation, but is overseen by the U.S. Department of Labor who provides states administrative costs of running the program. The program provides up to 26 weeks of benefits to unemployed workers who qualify and on average replaces about 40 percent of a worker's prior wages.[iii] Unemployment insurance typically only provides benefits to about 30 percent of all those who are unemployed. There are several reasons for this, including: some types of workers are not covered by the UI program (e.g., part-time workers or certain domestic or agricultural workers), there are issues in defining what counts as losing your job (in particular defining a "lay-off" or determining if a termination was for "good cause"), and some individuals are reluctant to apply.[iv, v,vi]

Unemployment insurance is funded by taxes paid by employers for their employees, collected by both the federal government and state governments. The Federal Unemployment Tax Act (FUTA) allows the Internal Revenue Service to collect a federal employer tax, which goes into the federal Unemployment Trust Funds. State tax rates, by comparison, vary significantly and total state taxes are much higher than federal since they provide most of the benefits. Typically, states set their tax rates for employers based largely on the employer's prior use of UI—a practice called experience rating. Some of the other factors that could go into an employer's experience rating (and thus tax rate) include length of liability, tax payments, taxable payroll, timeliness of payments, and benefit payments charged.

Compatibility with EXTO Purposes. Unemployment insurance, as a model, is compatible with extended time off purposes in a few ways. First, the UI system has a mechanism in place which is already used in some states to fund other workforce-related programs, like job training. For example, in Delaware, the Blue Collar Job Training Tax of between 0.1 and 0.15 percent per year of taxable wages funds counseling, training, and placement of dislocated workers. In addition, there has been movement by some states, through "good cause" provisions, to compensate unemployment related to family circumstances.[vii] Further, UI and EXTO policies share the broad goals of compensating periods of unemployment across a worker's life cycle. Finally, the UI system has an administrative structure in place for quick determination of eligibility and benefits, and has a process in place for getting funds to individuals in a timely manner.

Key Factors to Consider. In considering unemployment insurance as a potential model for providing extended time off, it is important to take into account several factors. First, the current method of using an employer's experience rating to determine its tax rate is not ideal for an extended time off program. Using this policy vehicle would require an alternative method for determining the tax rate that is not based on an employer's prior use of the benefit. In addition, UI eligibility is currently based on an applicant's prior earnings, attachment to the labor market, and the reasons for the particular loss of work, which may not be appropriate for extended time off purposes. Alternate eligibility criteria would likely be needed. Another factor to consider is take-up or participation. Typically, only 30% of eligible workers receive UI benefits and many eligible individuals do not apply for benefits. States must devise strategies to ensure that eligible individuals are aware of and participate in the extended time off program. The federal government must also oversee the program to ensure that states are compliant. Finally, it is important to consider how the policy would be financed. The current UI system is financed by employers, but using this model for paid EXTO would not necessarily need to rely on an employer payroll tax. Other options for financing might be states' general revenue funds, an employee payroll tax, or a tax shared between employers and employees.

Social Insurance Model – **Workers' Compensation**

Overview of the Model. Workers' compensation programs are state-regulated insurance programs that cover medical expenses, a portion of lost wages, basic rehabilitative services, and spousal death benefits for individuals who are hurt in the workplace. Workers' compensation is no-fault insurance, meaning that the individual does not have to prove that his/her injury was due to employer negligence and employers must cover occupational injury or illness. The first state law was passed in Maryland in 1902, and by 1949, all states had created some sort of workers' compensation program. Workers' compensation programs were created to reduce law suits and litigation surrounding workplace injuries. All states require employers to purchase workers compensation insurance, except for Texas, which makes it optional.

Workers' compensation programs are funded by employers who purchase insurance from private providers or a state fund. Employers may also self-insure, meaning that they pay for the administration of their workers' compensation program and the benefits awarded to workers. Employers' premiums also pay for administration of the program, which includes claims determinations. The premiums that employers pay are based, in part, on their industry classifications and the occupational classifications of their employees. In addition, many employers are experience rated, meaning that their premiums are affected by prior use of workers' compensation.[viii] In general, state funds are not used to fund the program, except when the state is the employer. The program is void of any federal funds, except again, when the federal government is the employer.

Compatibility with EXTO Purposes. Workers' compensation, as a model, is compatible with extended time off purposes in a few ways. First, state workers' compensation systems already have mechanisms in place to distribute funds for extended time off purposes, mostly related to the health needs of the worker. The goals of the coverage could be expanded to cover other extended time off needs. Further, workers' compensation is very portable. Since workers' compensation is employer-based and not dependent on the employee's work experience, it is provides more universal coverage, which makes it amenable to EXTO purposes. Finally, workers' compensation is universally provided, with all states (except Texas) requiring employers to purchase the insurance.

Key Factors to Consider. In considering workers' compensation as a model for an extended time off policy, there are several key factors to consider. First, employers' insurance premiums are based on their industry, but also on their prior use of and experience with workers' compensation (i.e., how many employees use it). As with unemployment insurance, a program modeled after workers' compensation would certainly need to be separated from the experience rating system, in order to avoid disincentives for hiring certain workers, such as women of childbearing age. In addition, many employers use private insurers to cover workers' compensation, creating an element of profiting from use of workers' compensation that may not be palatable with extended time off. The possibility that the public and employers might end up at the mercy of a few monopoly insurers, raises the need for a state fund or vigorous self-insurance options. Finally, evidence suggests that that take-up of workers' compensation is low relative to the number of people who are eligible. While many of the reasons why people do not file a claim for workers' compensation are irrelevant to a conversation about extended time off (e.g., workers often fail to apply because they underestimate the impact of the injury on their ability to work), other reasons, like the fear of retribution, could apply in the case of extended time off.

Social Insurance Model -- Social Security

Overview of the Model. Social Security, developed in 1935, is the most prominent federal social insurance system in the United States. In addition to providing retirement benefits to workers older than age 65, the program offers early retirement, disability, and survivorship benefits. Social Security is an earned benefits program, which means that only those who work and pay taxes are eligible for benefits, with some exceptions (e.g., disabled children who receive Supplemental Security Income (SSI) payments). This discussion will focus on two different aspects of the Social Security program – retirement benefits and Social Security Disability Income (SSDI). The retirement program provides retirement benefits to workers beginning at age 62, though benefits aren't provided in full levels until age 65. The Social Security Disability Insurance program provides benefits to individuals who have long-term (longer than one year) disabilities that keep them out of the workforce. Unlike retirement benefits, there are not age limits attached to these benefits. Social Security is financed through a joint employee/employer payroll tax. Employers and employees each put in the same percentage of wages (6.2 percent) for a total tax of 12.4 percent of wages. These taxes are taken out for all wages earned below a set wage ceiling, which is currently set at $102,000.

Compatibility with EXTO Purposes. Social Security, as a model, is compatible with extended time off purposes in a few ways. First, the Social Security mechanism has existing administration and infrastructure, which an extended time off program could tap into, including an existing network of local offices. In addition, there are some commonalities in policy goals between Social Security and extended time off. Both policies are based on the idea that if an individual works, then the government will ensure that they and their families are supported when they cannot work, either in times of old age or when disabled. Extending this philosophy to shorter periods of time off from work to create an EXTO policy would be compatible with the overall social insurance goals of the Social Security program. Moreover, the federal nature of this system eliminates some of the state variation present in other model mechanisms, like unemployment insurance, and ensures that all workers receive the same type of benefits.

Key Factors to Consider. In considering Social Security as a model for an extended time off policy, there are several key factors to consider. First, although there is an administrative structure in place, the current systems for both Social Security and SSDI are not set up to deal with delivering checks quickly. The SSA program is designed to administer checks based on an anticipated retirement date, and the SSDI program operates under a five month waiting period from the last day worked before a person may receive benefits. Therefore, the need to issue a check within a matter of weeks for EXTO would need to be addressed. In addition, the eligibility determination process for SSDI can be long and adversarial, so the claims process would need to be reevaluated if Social Security were to take on payments for paid extended time off. Eligibility requirements (i.e., number of quarters in the workforce), which are high in the case of retirement benefits, would also have to be revisited for extended time off, or some plan devised for younger workers who might have medical needs or have children early into their working careers. For example, could individuals who have not contributed substantial amounts at the time that they need extended time off be able to borrow benefits with the caveat that they will pay them back into the system in some way? What happens if someone exits the workforce after using paid leave that was "borrowed"? Finally, though Social Security is currently financed by both employers and employees, other financing options could be considered for an expansion to paid extended time off, including using general tax revenue funds or basing the program solely on an increase in employee payroll taxes.

Social Insurance Model -- Temporary Disability Insurance

Overview of the Model. The TDI program is in many ways a complement to unemployment insurance in that it provides benefits for individuals who are temporarily unable to work due to a health-related issue. Unlike Social Security Disability benefits, which require the individual to be permanently disabled or unable to work for a period longer than a year, temporary disability insurance provides benefits for more short-term needs. Five states and Puerto Rico currently have TDI programs – California, Hawaii, New Jersey, New York, Rhode Island. Not surprisingly, each state's program differs in terms of length of coverage, benefit levels, types of insurance purchased (e.g., state plan vs. private insurer), and other characteristics. Each state finances its temporary disability insurance program differently. In general, TDI benefits are covered by a shared employer/employee pay roll tax. Some states allow taxes on all wages up to a cap on the total amount an individual pays.

Contrary to wage replacement programs, TDI programs address the needs of disabled individuals, regardless of whether they are currently working, and unlike workers' compensation, even if they were not working at the time of their injury or illness.[ix] These programs also cover a worker who becomes unemployed as a result of the temporary disability, but offer no job protection despite offering income if the employer fires a worker. A major category of disability covered by TDI is pregnancy and birth. Individuals who become "temporarily disabled" due to pregnancy and childbirth are eligible to receive TDI benefits for the length of their disability. Typical duration for TDI benefits due to pregnancy and childbirth is 10 to 13 weeks.[x]

<u>Compatibility with EXTO Purposes.</u> As a model, Temporary Disability Insurance is compatible with extended time off purposes in a few ways. First, TDI programs are a proven system in six states, with a wealth of information to inform passage of the program in other states. Additionally, the TDI system is already being used to provide paid extended time off in one state (California), with more states looking at the model. California's Paid Family Leave Insurance program operates in tandem with the state's TDI program. It covers birth, adoption, or foster care placements, as well as sickness or injury of a child, spouse, parent, or domestic partner. The Family Leave Insurance program covers employees of employers covered by the state's TDI program (e.g., payrolls in excess of $100 per calendar quarter) who earned at least $300 in the base period. New Jersey recently passed legislation creating a program that resembles California's program. In addition, the policy purposes of TDI and extended time off are closely aligned. Both are intended to provide wage replacement during a relatively brief period of time when an individual is unable to work. There is also an overlap in covering pregnancy in that TDI gives coverage for mother's physical need, but not for additional time beyond recovering from childbirth, and does not cover fathers or adoptive parents. Finally, for those states that have TDI programs, this model would tap into an existing system simplifying administration and implementation.

California Paid Family Leave

Enacted in 2002, and effective in 2004, California's Paid Family Leave (PFL) program provides wage replacement for workers who need to take time off for up to six weeks within a twelve-month period. PFL compensates individuals who take time off work to care for an ill family member or to bond with a new child through the existing State Disability Insurance (SDI) program.

Eligibility – All workers, male and female, who pay into the existing SDI system (at least $300 in the base period), qualify for the paid family leave program. There is no minimum number of hours or days required at a certain employer to qualify. This leave must be taken to care for a seriously ill family member, to bond with a newborn, newly adopted child, or in connection to a foster care placement. Workers must submit appropriate medical certification if requested.

Benefit Amounts –Most workers will receive approximately 55% of their pre-taxed weekly wage, up to a maximum of $917 per week as of January 1, 2008.

Financing Structure – PFL is funded through an employee payroll tax. Contributions for PFL are incorporated into the SDI withholding rate, which is 0.8 percent in 2008, with taxable wage limit of $86,698 per employee. These employee payroll tax deductions cover all family leave expenditures.

Cost – On average, employees in California paid an additional $0.56 per week in payroll taxes in 2006 to ensure that they have family leave when they need it (see Boots, Macomber, and Danziger 2008). That same year, California paid out $367,900,000 in PFL benefits, covering 160,705 claims and an average weekly benefit of $436.

<u>Key Factors to Consider.</u> In considering temporary disability insurance as a model for providing extended time off, there are several important factors to consider. First, only five states and Puerto Rico currently have state temporary disability insurance programs. Therefore, to use this model nationally, most states would need to establish a similar type of extended time off program. In addition, while there is no empirical data on program take-up in TDI, many of the TDI programs are so closely aligned with unemployment insurance, they experience many of the same problems including coverage issues (e.g., part-time workers and other groups of employees may not be covered) and difficulty covering employees who are newest to the workforce.

Finally, the current system is financed by an employee, employer, or shared payroll tax. For extended time off purposes, it will be important to consider how to finance a TDI/EXTO program, with options of again using state general revenue, employee payroll taxes, or a combination of employer and employee payroll taxes.

Employer-Based Model -- Leave Banks

Overview of the Model. In general, a leave bank is a way for individuals to donate paid leave time to a bank where it can be saved for later use in the case of an emergency. Leave banks can be designed in a few ways. First, there could be a collective leave bank in which individuals pool their hours to provide time off. The federal government, for instance, has a leave bank program like this, called the Voluntary Leave Bank Program (VLBP). Large employers, such as universities, schools, and other government entities are typically the only types of employers that have leave banks for employees. Policies for leave banks vary by institution. A second type of leave bank is one in which the individual banks his/her own leave for personal use later. In other words, an individual might be able to take a few hours of sick leave or vacation time and bank it in a separate account to be used for extended time off purposes or employers could be required or incentivized into providing time to their employees for the express purpose of banking for extended leave needs. Regardless of the mechanism, the leave banks are effectively paid for by employers. However, in some scenarios, leave banks represent a shifting of already existing benefits so that there is no additional cost to employers, beyond the cost of administering the system.

Compatibility with EXTO Purposes. A leave bank, as a model, is compatible with extended time off purposes in a few ways. First, there are some similarities between the policy goals of extended time off and the leave bank policies described here, such as the "insurance" element in that one banks leave because he/she thinks there is the possibility that he/she will need emergency medical leave for one's self or family member in the future. In addition, leave banks, for the most part, tap into existing benefits, meaning that there may be minimal additional costs to both employers and employees if paid time off is already provided. Moreover, if a leave bank is shared across employees, then an individual could take a larger amount of leave than he/she has contributed at that point in time. This may be particularly useful for younger individuals who would like to take extended time off to care for a new child. Finally, this system, while employer-based, spreads its costs (and benefits) among employers and employees with little government financing (except when the government is the employer or in cases where the government provides resources to incentivize, rather than require, employers to participate).

Key Factors to Consider. In using leave banks as a potential model to provide extended time off, it is important to consider a few key factors. First, leave banks are relatively rare and the costs of creating these types of systems could actually be quite high for employers, particularly if the organization does not provide vacation time and/or sick leave. At the same time, the low take-up and availability of such programs currently suggests that this policy might be difficult to enact or to provide universally. Policymakers should therefore consider either mandating leave banks (which in effect mandates the provision of some paid vacation or sick leave for employees) or providing strong incentives for employers to set up a leave bank system (using tax incentives or other means to encourage employer take-up of program provision.)

Another issue to consider is portability. Except for the federal government's program, leave banks are attached to an employer, which limits portability unless all employers are required to have a leave bank, and employees could transfer their accrued leave from one bank to another. Otherwise, there is a possibility that an employee would lose his/her accrued leave if he/she changed jobs. Moreover, there is an element of planning involved with leave banks, such that individuals who do not plan for medical leave (which is often unexpected) may not be able to participate unless employees can 'borrow' time from the bank. In addition, leave banks, if participation by employees is voluntary, alert the employer that an employee plans to take extended leave at a later date, which could have implications for employers' treatment of employees and employees' participation. Finally, leave banks may not be a realistic option for small employers because there are not enough employees to spread the costs and benefits across. One of the fundamental elements of a leave bank is its ability to pool benefits and costs across a large group of employees. In a small employer with few employees, pooling would be very difficult.

Employer-Based Model -- Employer Mandate

<u>Overview of the Model.</u> An employer mandate would require employers to provide extended time off to employees. This mandate may or may not be supported by a government subsidy or tax credit for employers to help offset some of the costs.[xi] Generally speaking, financing for an employer mandate typically comes from employers. However, economists argue that, like the social security payroll tax, any employer-provided benefit is actually financed by employees. The theory is that employers pay for these benefits by lowering employee wages or otherwise passing on the increased labor costs to their employees or their customers. As a result, there might be overall economic effects; namely through job losses or higher prices for consumers.

<u>Compatibility with EXTO Purposes.</u> An employer mandate, as a model, is compatible with extended time off purposes in a few ways. First, an employer mandate eliminates some of the challenges/issues with other mechanisms, such as achieving universal coverage, which would be more likely under an employer mandate. Thus, many more people would be able to access paid leave for extended time off reasons. In addition, while there is no universal, existing, paid extended time off program, there are some models for this mandate. For example, the Family and Medical Leave Act is an employer mandate that requires covered employers (typically those with more than 50 employees) to grant 12 workweeks of unpaid leave to eligible employees for the following reasons: birth and care of the newborn child of the employee; placement with the employee of a son or daughter for adoption or foster care; to care for an immediate family member (spouse, child, or parent) with a serious health condition; or to take medical leave when the employee is unable to work because of a serious health condition.[xii]

<u>Key Factors to Consider.</u> In creating an employer mandate as a mechanism to provide paid, extended time off, there are a few key factors to consider. First, eligibility for the program must be considered carefully. As with the Family and Medical Leave Act, some groups of workers might be excluded from the paid EXTO, including part-time workers. These individuals could be

most in need of these policies, for instance, mothers who currently work part-time and need to take time off to care for a sick child. In addition, an employer mandate would require a great deal of oversight to ensure that employers did not discriminate in hiring based on who they thought might use EXTO programs. Additionally, other compliance and provision of benefit issues might require a third party to adjudicate claim disputes. Further, government might need to play a role in ensuring that employers did not dissuade employees from using the benefit. Another consideration is what might happen to those workers who already have paid leave. If this leave exceeds the mandated level, there may be a reduction in benefits, making some workers less well off. There could be, in effect, a "race to the bottom." Finally, it is important to consider the potential financing schemes for an employer mandate. Given the current state of the economy, any rise in employers' costs may have an impact in their demand for labor. Offsetting costs to employers would likely require government reimbursements or tax credits, which could mean additional costs for the federal government, which raises fiscal and political challenges.

Employer-Based Model -- Employer Hybrid Benefit

Overview of the Model. An employer-hybrid model is a model that is employer-provided, but not necessarily financed by employers. Currently, there are no existing examples of a hybrid model like those described here being used to provide extended time off. Some examples include cafeteria plans, supplemental unemployment insurance, and 401(k)s. The common theme among these mechanisms is that the program is often delivered through the employer, while the financing is mixed, with some models financed by the employee, some financed by the employer, and some where the financing is shared between the two. Government can play a role in incentivizing the benefit, often by forgoing revenue under these models, or by deferring tax revenue until the time when an employee cashes out the benefit.

More specifically, *cafeteria plans*, which operate under Section 125 of the IRS code, enable employers to give employees a set number of "credits," which they can use to select the benefits that they want, much like choosing food in a cafeteria. Applied to extended time off, one could imagine that an individual could use his/her "credits" to purchase paid leave as part of the cafeteria plan. To contrast, *supplemental unemployment benefits* allow employers to provide employees with additional compensation (beyond unemployment insurance) when they are laid off from their jobs. Employers contribute to a fund, which is used to provide benefits to employees who are laid off. There are also tax benefits for the employers as payments into these funds are not subject to Social Security, Medicare, or federal and state unemployment taxes. Finally, a 401(k)—a type of employer-provided retirement benefit operating under section 401(k) of the IRS Code—enables the employee to make direct contributions from his/her salary into an account and defer taxes until the funds are withdrawn in retirement. In some cases, employers match employee contributions, but this is not required.

Compatibility with EXTO Purposes. As a mechanism to provide extended time off, the employer hybrid model is compatible with EXTO purposes in a few ways. First, full wage replacement may be possible under this model. In the case of 401(k) plans, for example, an individual can contribute a relatively large amount of money, meaning that wage replacement could be high (subject to contribution limits). In addition, the hybrid models discussed here have existing structures which an extended time off program could tap into. For instance, employers already use supplemental insurance compensation funds to provide extra benefits to employees who are involuntarily terminated. Finally, at least one of these mechanisms already provides wage replacement for purposes beyond that of the original policy goal. With 401(k) plans, for instance, there are ways in which individuals can access their accounts before retirement, such as hardship withdrawals (e.g., unreimbursed medical expenses, purchasing a home, college tuition, funeral expenses, and home repairs), which incur a 10 percent penalty for early withdrawals, and other circumstances (e.g., becoming totally disabled, incurring severe medical expenses, alimony or child support payments, or job separation under certain conditions), which are not subjected to a penalty. Similarly, in cafeteria plans, paid vacation is one of the options that an individual can select. It is possible that this idea could be expanded to provide an extended time off option.

Key Factors to Consider. In using an employer hybrid model as a way to provide extended time off, there are a few key factors to consider. First, with the exception of 401(k) plans, employer use of these hybrid models is relatively limited. In creating an extended time off program, it is important to understand why employers do not use cafeteria plans or provide supplemental unemployment compensation in larger numbers. In addition, take-up or participation in these programs may be low. Additionally, as noted in the 401(k) literature, many eligible individuals do not open an account, and those that contribute do not always do so in large amounts, even with employer support. This also relates to the issue of portability. Since some of these models are tied to an employer, making the program portable is an important component to address. Another consideration is exactly how the program will be structured. For instance, will it be like cafeteria plans in that individuals can elect to participate? Or, will it be modeled more after a 401(k) as an individual account that is employer-based, but completely portable? Finally, it is necessary to think about how this program would be financed. The premise of the hybrid model is that it is employer-sponsored, but not necessarily employer financed. Therefore, the financing of these types of models might consider what role employees, employers and the federal government might play in mandating or incentivizing use and availability.

Individual-Based Model -- Individual Accounts

Overview of the Model. An individual account model would develop individual accounts in which workers can save money to use for extended time off. While there is currently no individual savings program to fund extended time off, there are many different types of individual accounts that an extended time off account could be modeled after. These examples include Individual Retirement Accounts (IRAs), children's savings accounts, Individual Development Accounts (IDAs), 529 Savings Plans, Health Savings Accounts (HSAs), or Health Reimbursement Accounts (HRAs). Each of these accounts varies in its structure, purpose, eligibility, financing, administration, and several other components. The distinguishing feature of individual accounts is that they are often individually-financed. However, depending on how the system is structured, they also include matches from the federal government, state governments, or another private source. Some individual accounts often also have indirect government contributions since they are tax-preferred savings plans. Tax-preferred savings plans are so named because they offer tax-exempt accrual on capital income in the account, but are often limited by how much an individual can contribute. In some cases, like the Health Savings Accounts, the employer can also play a role in financing individual savings plans.

Compatibility with EXTO Purposes. Individual accounts, as a model, are compatible with extended time off purposes in a few ways. First, the policy goals of many of these accounts align closely with that of extended time off. The accounts noted here serve two main goals: wage replacement (individual retirement accounts) and insurance for unknown needs (health savings or health reimbursement accounts). Other accounts, like individual development accounts, child savings accounts, and 529 plans, are savings mechanisms that enable individuals to save for things that they think will need in the future (e.g., a house, college education, car, etc.). In addition, individuals could save as much as they want in these plans, which gives workers some flexibility in determining wage replacement. Workers do not need to rely on a given benefit amount, which can be significantly lower than weekly wages. Finally, the nature of these programs makes them extremely portable for workers.

Key Factors to Consider. In setting up an individual account to provide extended time off benefits, there are a few key factors to consider. First, participation in these programs can be fairly low, and evidence suggests that many eligible individuals do not participate. In creating an individual account to provide extended time off, it is necessary to determine why eligible individuals do not participate since these programs are (for the most part) voluntary. At the same time, those who currently participate in these accounts tend to have higher incomes. Tax-preferred accounts tend to benefit those with higher incomes who have more disposable income to save and may use these accounts as a tax shelter in which interest accrues tax-free. Another consideration requires balancing the voluntary nature of individual accounts with the need for foresight in creating them. Individual accounts require an individual to have the foresight, desire and financial ability to save for something that may or may not happen. For lower income workers and newer workers entering the labor market, the ability and foresight needed to save might be a significant hurdle to overcome, even with strong financial incentives. Moreover, timing is an important factor to consider. Parents may not have much time in the labor force prior to having a child, which reduces the amount of money that they can save in an account. Savings may not be high enough to provide real wage replacement for certain individuals. Finally, it is important to consider how these accounts will be structured, financed, and administered. While the bulk of financing will come from the individual, there is a question of whether the government and/or employers will contribute and at what levels, as well as whether there will be any preferential tax treatment for the accounts.

Individual-Based Model—Tax Credits

Overview of the Model. The U.S. tax code offers another potential individualized vehicle to providing wage replacement for extended time off, namely through a tax credit. There are numerous tax credits in the U.S. tax code, each with its own rules and requirements. However, only a few individual credits provide some advance option that would address the need for income at the time of leave taking. Some potential models for an individual extended time off tax credit include: Earned Income Tax Credit, the Health Coverage Tax Credit (HCTC), and a Health Insurance Tax Credit (HITC) proposed by the Bush Administration in 2004 and 2005. Each of these tax credits are designed differently and aim to fulfill a different purpose. For example, the EITC seeks to provide a tax credit for eligible taxpayers to give "an added bonus or incentive for low-income people to work" and to help "individuals with families receiving Federal assistance to support themselves."[xiii] To contrast, the Health Coverage Tax Credit provides 65 percent of health care premiums for qualified workers, and was designed to cover certain trade-dislocated workers, namely those eligible to receive Trade Adjustment Assistance or Alternative Trade Adjustment Assistance. Like individual accounts, these tax credits do not utilize pooling or any type of group coverage as in an insurance model, but rather use the tax code to deliver a credit for certain activities (e.g.., rewarding work) or for certain expenses (e.g., purchasing health insurance).

Tax credits, in general, are typically deferred revenue for the federal government, and are thus financed primarily by the government. Depending on how the credit is structured, employees and/or employers could also be required to contribute to the wage replacement plan, with the government providing just a portion of costs. For example, in the HCTC and the HITC, the employee is required to pay a certain portion of their health care premiums.

<u>Compatibility with EXTO Purposes.</u> A tax credit, as a model, is compatible with the purposes of extended time off in a few ways. First, tax credits in general are designed to help incentivize behavior or address the costs of services (such as child care) or items (houses) that policymakers deem are in the best interest of society or the citizenry. In that sense, funding EXTO through a tax credit model is an expedient way to reimburse workers for legitimate time out of the workforce. Tax credits are also available to anyone who files tax returns, and depending on whether or not it is refundable, are available to all workers regardless of income. Furthermore, credits are not determined on a workers' employment or whether they stay with the same employer throughout the year, but are typically based on income and meeting the qualifying conditions for the credit.

Additionally, administration of a tax credit is relatively simple, since the credit would be folded into the existing tax code. However, this task becomes more complex and the administrative costs rise when addressing the goal of having wage replacement available at the time that leave is taken. In general, the Department of Treasury and IRS are not set up to make frequent payments to individuals, especially payments that are outside of the normal tax return timeline. Further, the Treasury Department's systems for establishing eligibility for certain tax treatments are not typically quick, which makes expedient turnarounds in eligibility determination and payments difficult. Using the EITC and HCTC models, we know that there are ways to advance workers with their credit, so again, with some modifications, using the tax system might be an efficient way to deliver paid time off to workers.

<u>Key Factors to Consider.</u> In developing an extended time off tax credit, there are a few key factors to consider. As we mention above, the issue of timeliness of the payment is critical to using this model since ideally, workers would not have to wait until the end of the year to receive their credit for paid time off. However, workers could receive the benefit at the time of leave taking through an advanced credit, where employers helped in both determinations of eligibility and distribution of funds for the credit. In addition, the decision for eligibility determination needs some consideration as well. If the Treasury is making determinations of eligibility, then we know from experience with the HCTC that the turnaround time is quite slow. The EITC demonstrates a model of employers in assisting with eligibility determination, but that would require an additional effort for those employers not currently certifying unpaid leave for workers under the FMLA. (Note that approximately 40 percent of all employees work for employers that

are not covered by FMLA rules.) Finally, while tax credits are typically funded by deferred revenue, policy designers might want to try to address the financing of these credits, either by an increase in worker or employer taxes, or both, to offset the costs of a tax credit.

In addition to a tax credit for individuals, a variety of employer tax credits could be provided to fully or partially reimburse employers for providing paid leave. We outlined one scenario under the employer mandate section, where tax credits could be used to help finance an employer mandate by reimbursing all or part of the cost of paying wages to the leave-taking employee. However, one could design a tax credit policy in a number of different ways, including an employer tax credit policy that did not involve a mandate, but instead created market-based incentives for employers to provide wage replacement for their workers.

Table 1: Overview of Potential Extended Time Off Policy Models

	Vehicle or Sponsor	Who Currently Finances?	Administration	Any Coverage/Take-Up Issues?
Social Insurance				
Unemployment Insurance	State government with federal oversight	Employer	Joint state and federal government	▪ Certain groups excluded, including part-time workers, new workers, re-entrants to the workforce and workers in some industries like agriculture. ▪ Research shows that many eligible individuals do not file claims for various reasons including lack of knowledge of eligibility or didn't feel that they would need it (i.e., thought they would find a job).
Worker's Compensation	State government	Employer	State-run, but private insurers administer	▪ Based on whether injury occurred at workplace. All workplace injuries are covered with a few exceptions. ▪ Research shows that many eligible individuals do not file claims for various reasons including: don't think condition is serious enough, did not expect to miss work, had other income, used medical insurance, or feared retribution.
Social Security – Retirement	Federal government	Individual and Employer	Federal government	▪ Based on age and previous contributions to the system. ▪ Take-up of benefits is very high. More than 90 percent of individuals over age 65 receive benefits.
Social Security – Disability	Federal government	Individual and Employer	Federal government	▪ Based on an individual's inability to work for at least a year or permanently. ▪ Take-up is limited because many claims (40%) are initially denied, though significant numbers are won on appeal.
Temporary Disability Insurance	State government	Individual and Employer	State government, typically through Department of Labor or equivalent	▪ Certain groups excluded: government employees, domestic workers, family employees, railroad and maritime workers, part-time workers, corporate officers, and certain employees of religious or charitable organizations. ▪ There is no literature around take-up of TDI among eligible individuals. Evidence from California shows that 750,000 received TDI benefits in 2007.
Employer-Based				
Leave Banks	Employer	Employer and Employee	Individual employers	▪ No restrictions, although individuals must contribute in order to participate. ▪ There are some portability issues in that an individual may lose all of his/her banked leave if changing

	Vehicle or Sponsor	Who Currently Finances?	Administration	Any Coverage/Take-Up Issues?
				employers. ▪ There is no literature around participation in leave banks, though anecdotal evidence suggests that they are popular.
Employer Mandate	Employer	Employer	Individual employers	▪ Not necessarily, though certain types of workers, such as part-time workers, could be excluded. ▪ Participation in the program would likely be high, though fear of retribution could reduce take-up.
Hybrid Model	Employer	Employee and (in some cases) Employer	Individual employers, but private insurers or investment firms could also administer	▪ Depends on the model. ▪ Portability may also be an issue depending on the model. Some things like supplemental unemployment or cafeteria plans are not portable if switching jobs. ▪ Research on 401(k) plans shows that many eligible individuals do not have them or do not contribute. Further, many employers do not offer cafeteria plans or supplement unemployment compensation. Program take-up is an issue for this type of model.
Individual-Based				
Individual Accounts	Individual	Individuals with sometime employer or government matches	Organization that "holds" the account, including investment firms, non-profit groups, financial institutions, or insurance companies.	▪ Depends on the model. ▪ There are some participation issues in many of these models, such as IDAs, IRAs, and HSAs. Beyond participation, research suggests that individuals who contribute do not necessarily do so in large amounts.
Extended Time Off Tax Credit	Individual	Government (lost revenue) and sometimes Employer or Employee	IRS/Government (though the proposed model could be administered jointly with employers)	▪ Depends on the model. ▪ There are some participation issues in some of the existing tax credits like the EITC and HCTC. Similarly, the advance payment option for the EITC has extremely low take-up.

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