

Benefits Alert

November 2009

IRS Releases A Potpourri Of 401(k) Plan Guidance

The IRS has released a blizzard of rulings that encourage employees to contribute more into their 401(k) accounts. Included in this paper blitz are two rulings that allow employees to contribute unused annual time off into their plans, one ruling that allows automatic contributions to increase as employees' salaries increase, a notice regarding distributions from Roth 401(k) plans, and model plan amendments and notices.

CONTRIBUTING TIME OFF

The IRS has clarified that employees may contribute, or have contributed on their behalf, unused annual paid time off (PTO) or PTO they have accrued at termination, into their 401(k) accounts. However, the overall limitation on employees'

contributions, otherwise called the section 415 limitation, continues to apply.

PTO contributions are *non-elective contributions* if the PTO plan doesn't allow employees to carry unused PTO into the next year, and the 401(k) plan requires that the PTO be contributed into the plan. *Snag:* The value of PTO that must be distributed to employees because the section 415 limit is exceeded is included in their gross income in the year received, and is subject to the 10% tax on early withdrawals, unless employees are 59½ years old or they terminate after reaching the age of 55.

PTO contributions are *elective contributions* (i.e., pre-tax contributions) if the PTO plan allows employees to carry some PTO into the next year, and

In This Issue

- IRS Releases A Potpourri Of 401(k) Plan Guidance
- Final Regs Allow Non-Comparable HSA Contributions
- Ask The Experts
- Get Ready For Medicare Part D Reporting

to contribute some or all of the remainder into the 401(k) plan. Similarly, terminating employees may elect to contribute some of their PTO into the plan. *Same snag:* The value of PTO that must be distributed to employees because the section 415 limit is exceeded is included in their gross income in the year received. *New twist:* The value of PTO paid to employees who don't contribute all of their PTO into the 401(k) plan, and that isn't carried over into the next year, is subject to payroll taxes.



Robert S. Golden
M. Dennis Guappone
Stephen H. Peck

Expertise
Innovation
Excellence

181 Wells Avenue
Newton, MA 02459
Phone: (617) 969-0100
www.ubserv.com

Benefits Alert

IRS Releases A Potpourri Of 401(k) Plan Guidance (cont.)

AUTO-ENROLLMENT PLANS

Employers may amend their 401(k) plans to include qualified automatic contribution arrangements (QACAs) or eligible automatic contribution arrangements (EACAs). These 401(k) plans require employees to opt out to receive their full salaries. QACAs and EACAs share many characteristics, but EACAs may allow employees who opt out to receive distributions of their automatic contributions.

The IRS says that for QACAs and EACAs, automatic contributions may increase in the second and subsequent plan years based on increases in employees' salaries. The IRS has also clarified that increases in default contributions into QACAs or EACAs may be made on dates other than the first day of the plan year (e.g., employees' anniversary dates or another designated date).

The IRS has also released sample plan amendments for QACAs and EACAs.

ROLLOVERS FROM ROTH 401(K) PLANS

The income that accumulates in after-tax Roth IRAs generally isn't taxed. Roth 401(k)s, which also require after-tax contributions, have the same tax advantages upon distribution. However, for years beginning before 2010, restrictions apply to Roth IRAs, so departing employees who want to directly roll their pre-tax, traditional 401(k) assets into Roth IRAs can't do so if their modified adjusted gross income exceeds \$100,000, or they're married but file separate returns. These restrictions dis-

appear completely and forever beginning in 2010.

Regardless of the income and filing restrictions that apply to Roth IRAs, these four rules apply when employees who hold 401(k) assets, including Roth 401(k) assets, terminate employment.

- Employees who don't directly roll over their 401(k) assets into another qualified plan or an IRA are subject to a 20% withholding tax.

- Roth 401(k) assets may only be rolled over into Roth IRAs.

- Employees may convert non-Roth IRAs into Roth IRAs, but the amount converted is included in their income and is taxable.

- Direct rollovers from traditional 401(k) plans into Roth IRAs aren't subject to the 20% withholding tax or the 10% tax on early withdrawals, even though the rollover amounts, less any after-tax contributions, are includable in employees' gross income and are taxable.

While Roth IRAs/401(k)s will become better deals once the income and filing restrictions expire, some important constraints remain. For example, taxpayers must hold their Roth accounts for at least five years before distributions achieve tax-free status. This holding period could be problematic for employees who terminate before the five years lapse. The IRS has clarified that the holding period and other limitations don't apply to rollovers from Roth 401(k)s into Roth IRAs. In addition, for rollovers from Roth 401(k)s into Roth IRAs before December 31, 2009, no income or filing limits apply,

even though the limits apply to Roth IRAs, the IRS said.

EMPLOYEE NOTICES

Employees who terminate employment must receive a notice regarding their distribution options. To make it easy, the IRS has created a model notice plans may use. The last version of this model notice was issued in 2002. The IRS has now updated this model notice. Also included is a new notice related to rollovers of Roth 401(k) assets.

REQUIRED MINIMUM DISTRIBUTIONS

For 2009, retirees aren't required to take required minimum distributions (RMDs) from their retirement plans or IRAs. Guidance from the IRS gives plan participants who have already received their RMDs for 2009 until the later of November 30, 2009, or 60 days after the date they received their RMDs, to roll over their RMDs into IRAs or another employer's plan.

The IRS has also provided plan sponsors with two sample plan amendments that they may adopt or use to amend their plans to either stop or continue 2009 RMDs. Both plan amendments provide that plan participants or beneficiaries can choose to receive their 2009 RMDs, or not. Also, both amendments allow employers to offer direct rollover options of certain 2009 RMDs. Sponsors have until the last day of the first plan year beginning after January 1, 2011, to adopt the appropriate amendment. *Caution:* Sponsors may need to tailor the sample amendments to their plan's particular terms and administrative procedures. ❖

Final Regs Allow Non-Comparable HSA Contributions

The golden rule with respect to employer contributions into employees' health savings accounts (HSAs) is this: If an employer contributes into the HSA of *any* eligible employee, it must contribute a comparable cash amount or percentage of the high-deductible health plan's deductible into the HSAs of *all* comparable participating employees as of the first day of the month. Final regulations, effective for employer contributions made on or after January 1, 2010, provide several exceptions to this so-called comparability rule. *Key:* These HSA rules don't apply if HSAs are part of cafeteria plans.

EMPLOYER HSA CONTRIBUTION RECAP

Under the HSA rules, employers must group together similar employees and their high-deductible health plan coverage. There are only three acceptable groups: full-time employees, part-time employees (i.e., those working fewer than 30 hours a week), and

former employees. There are two categories of coverage for high-deductible health plans — self-only or family coverage. Family coverage may be further broken down into self-plus-one, self-plus-two, and self-plus-three-or-more.

After employees and their high-deductible health plan choices are grouped, employers, in accordance with the comparability rule, can decide whether or how much to contribute into each employee's HSA. It is acceptable under the comparability rule, for example, for employers to make contributions into the HSAs of employees with family coverage and not into the HSAs of employees with self-only coverage.

EXCEPTIONS TO THE COMPARABILITY RULE

While the comparability rule takes an all-things-being-equal approach to employer contributions, the final regs detail the circumstances under which employers may make larger contributions into some employees'

HSAs.

- Employees who become eligible for HSAs mid-calendar year (up to December 1 of the calendar year) may still receive full-year contributions. Even though these employees' HSAs receive greater monthly contributions, the comparability rule still applies. *Upshot:* Employers that decide to make full-year contributions for mid-year-eligible employees must do so for all similarly situated employees in the same group (e.g., all mid-year-eligible employees with self-only coverage). *Warning:* Employers that opt not to make full-year contributions for mid-year-eligible employees must make pro-rated contributions based on the number of months those employees are eligible for HSAs.

- Employers may contribute more into non-highly-compensated employees' HSAs than into highly-compensated employees' HSAs. Again, the comparability rule applies, so employers that decide to make greater contributions into non-highly-compensated employees' HSAs must do so for all similarly situated employees in the same group.

Ask The Experts

Q. *Our 401(k) plan allows employees to borrow from their accounts. One of the owners of the company has filed the loan paperwork. Can owner-employees borrow from the plan?*

A. An owner-employee can borrow from the plan, provided he/she follows the same rules that apply to all participants. The loan must be in writing, interest must be charged, the owner must pay back the loan in equal installments over not longer than a five-year period, and the loan must be limited to \$50,000 or 50% of his/her vested balance. If these requirements aren't met, it may be a prohibited transaction. What's never allowed is an employer dipping into plan assets — maybe informally borrowing a little just to tide it over — to meet payroll or pay other bills and paying it back later.

Get Ready For Medicare Part D Reporting

November begins open enrollment for Medicare beneficiaries seeking Part D prescription drug benefits. This time is not only crucial for Medicare beneficiaries, but also for plan sponsors that are applying to the federal government for drug subsidies. To enable all parties to make the proper decisions, the Centers for Medicare and Medicaid Services (CMS) has released some 2010 inflation-adjusted figures. To further assist Medicare beneficiaries in the decision-making process, plan sponsors that provide prescription drug coverage must fulfill paperwork responsibilities.

2010 MEDICARE PART D FIGURES RELEASED

Plan sponsors that are applying to the CMS for a prescription drug subsidy must use a monthly figure of \$31.94 (\$30.36 in 2009), which is the national average Part D premium, to determine whether their benefits are actuarially

equivalent to Medicare Part D benefits. In addition, the CMS has announced that the average monthly premium that beneficiaries will pay for standard Part D coverage will be \$30, a \$2 increase from 2009.

MEDICARE PART D NOTICES DUE SOON

Plan sponsors that provide prescription drug coverage are reminded that they must provide active and retired Medicare-eligible employees, Medicare beneficiaries who are disabled or on COBRA, and Medicare beneficiaries who are covered as spouses or dependents (including spouses and dependents who are disabled or covered under COBRA) with the annual Medicare Part D notice of creditable/non-creditable coverage prior to November 16, 2009.

These notices are extremely important to Medicare Part D-eligible employees who don't enroll in Part D when first eligible, since they may have to pay more for Medicare drug coverage if

they can't produce a certificate of creditable coverage. While only Medicare-eligible employees must receive notice, sponsors may find it easier to distribute notices to all employees and their beneficiaries, regardless of Medicare-eligibility status.

Sponsors have flexibility in how notices are delivered. Electronic delivery that meets the Department of Labor's standards for electronic communication is fine. Under these rules, notice may be provided electronically to plan participants who consent to electronic delivery, and who can access the sponsor's electronic communications system on a daily basis as part of their work duties. *Reminder:* Sponsors must inform participants that they're responsible for providing a copy of the electronic notice to their Medicare-eligible dependents covered under the health plan.

The CMS has updated the Model Creditable, Non-Creditable, and Personalized Individual Disclosure notices that Medicare-eligible employees must receive. The updated model notices must be used on or after January 1, 2009. ❖

* * * * *

Final Regs Allow Non-Comparable HSA Contributions (cont.)

- Through December 31, 2011, employers may allow employees to make a one-time rollover of their health flexible spending account balances into HSAs. These so-called qualified

HSA distributions are subject to a unique comparability rule: If employers offer qualified HSA distributions to any employee, they must offer them to all employees who are covered under

any high-deductible health plan (e.g., a spouse's plan). However, employers can limit these distributions to employees who are covered under their high-deductible health plan. ❖