Updates on Safe Harbor 401(K) Plans, Healthcare Exchanges, Cafeteria Plans, and Retirement Plan Contribution Limits

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NEW GUIDANCE ON SAFE HARBOR 401(K) PLANS

In November 2013, the IRS issued final regulations addressing the issue of when a 401(k) plan sponsor can change its mind about making "safe harbor" matching or nonelective contributions (a nonelective contribution is an employer contribution made regardless of the amount the participant defers). A safe harbor 401(k) plan avoids the costs of performing nondiscrimination testing by agreeing instead to provide either matching or nonelective contributions at a safe harbor level for a given plan year. The safe harbor level for a matching contribution is $1.00 for $1.00 on the first 3% of pay deferred and 50 cents on a $1.00 on each dollar deferred exceeding 3% of pay but not exceeding 5% of pay; and for a nonelective contribution, the safe harbor level is 3% of pay.

As a general rule, a plan sponsor must announce prior to the beginning of a plan year its intent to make a certain level of matching or nonelective contributions for the upcoming plan year. The announcement notice must be provided at least 30 but not more than 90 days prior to the new plan year. In particular with regard to matching contributions, the thinking has been that if participants are given advance notice that certain elective deferrals made by the participant will be matched at a defined level, the more likely it is that participants will decide to make such deferrals.

When the economic downturn started back in 2009, many plan sponsors found they were financially unable to make the promised safe harbor contributions. While IRS regulations have for many years permitted a plan sponsor to cease making safe harbor matching contributions in the middle of the plan year provided notice and amendment requirements were met (no showing of hardship was required), that relief did not extend to nonelective contributions. In 2009, the IRS granted limited relief to plan sponsors needing to cease making safe harbor nonelective contributions. The relief was restricted to those employers that could show a substantial business hardship.

The final regulations issued on November 15, 2013, (78 FR 68735) state an employer wishing to cease safe harbor nonelective deferrals midyear does not have to show a substantial business hardship but instead: (1) it must show it is operating at a loss as defined under Code Section 412(c); and (2) it must have given notice prior to the beginning of the plan year reserving the right to not make the nonelective contributions. A notice to participants must be given once the decision is made to not make such contributions.

The IRS also imposed on safe harbor plans making matching contributions the same requirement of showing an operating loss as plans making nonelective contributions. As mentioned above, previously no such showing was required.

The regulations have an immediate effective date for safe harbor plans with nonelective contributions, and an effective date of plan years starting on and after January 1, 2015, for safe harbor plans with matching contributions.

FEDERAL AGENCIES MAKE IT MORE DIFFICULT FOR EMPLOYERS TO SEND EMPLOYEES TO EXCHANGES

There has been frequent speculation that employers, especially smaller employers, will be more inclined to send employees to an exchange to purchase individual health insurance than to continue to maintain an employer-sponsored group health plan. In particular, some employers thought they would provide a subsidy for such purchases by granting employees a credit under a health reimbursement arrangement to be used by an employee to purchase an individual health insurance policy.

Guidance issued on September 13, 2013, by the IRS in Notice 2013-54 (IRB No. 2013-40, September 30, 2013) and by the Department of Labor in Technical Release 2013-03 (40 BPR 2189) appears to make such an approach

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difficult to accomplish. The guidance provides that if an employer provides credits through a health reimbursement arrangement for an employee to purchase individual health insurance in the exchange, the health reimbursement arrangement will not be considered to be integrated with the individual health insurance policy, meaning the employer will still be viewed as being in violation of the Affordable Care Act requirements of having no annual limits on benefits and no cost sharing for preventative care. If the employer sponsors its own group health insurance policy that meets the minimum value requirement of the Affordable Care Act requirements, then the health reimbursement arrangement would be considered integrated. Additional requirements apply if the employer offers a group health plan but that plan does not meet the minimum value requirements.

While many employers do not presently offer a health reimbursement arrangement (a plan that is funded only by employer contributions), many employers sponsor a cafeteria plan. This guidance makes clear that an employee is not permitted to pay premiums for an individual insurance policy purchased through the exchange through a cafeteria plan. It remains an open question whether it is permissible for an employee to pay premiums through a cafeteria plan for an individual health policy that is not sold through the exchange.

It should be noted that even though small employers (50 or fewer employees) are not subject to a penalty if they do not provide health insurance to employees, any purchase of insurance by a small employer through the SHOP exchange (Small Business Health Options Program) can likewise not use funds from a health reimbursement arrangement or cafeteria plan.

TWEAK TO CAFETERIA PLAN RULES

For many years, employers that sponsor Code Section 125 ("cafeteria") plans have argued that the required use-it-or-lose-it rule forces employees to either forfeit an account balance derived from before-tax payroll deductions or else engage in unneeded year-end healthcare expenditures to avoid a forfeiture. While the IRS in the past maintained that the use-it-or-lose-it policy was necessary for the cafeteria plan to act like an insurance policy, in light of the reduction in maximum contributions to a healthcare flexible spending account to a maximum of $2500 per year, the IRS has concluded there was no longer a risk that a rollover of such accounts could turn into a form of deferred compensation.

Notice 2013-71 provides that a cafeteria plan may be amended at the discretion of the sponsor to provide that $500 of a participant's account balance can be forwarded to the following plan year of the cafeteria plan. No more than $500 can be forwarded so there is no aggregation of forwarded amounts.

If a plan is amended to make this change, then the plan cannot have a "grace period," which is a discretionary provision where a plan sponsor could let a participant seek reimbursement for healthcare expenses incurred within two-and-a-half months after the end of a plan year with salary reduction contributions that were made in the prior year. A plan can have the $500 rollover provision or a grace period, but not both.

BENEFIT CONTRIBUTION LIMITS FOR 2014

On October 31, 2013, in Rev. Proc. 2013-35, the IRS announced the following limits that will be applicable for calendar year 2014. The consumer price index increased by 1.5%, so certain limits were changed but other limits require a statutory threshold before an increase occurs, and the 1.5% increase did not meet that threshold:

- Defined benefit plan annual benefit limit: $210,000 (increase of $5000);
- Defined contribution plan annual contribution limit: $52,000 (increase of $1000);
- Maximum compensation that can be recognized: $260,000 (increase of $5000);
- Elective deferrals under 401(k), 403(b), and most 457 plans: $17,500 (no change);
- Catch-up contribution limit for participants age 50 or more: $5500 (no change);
- Compensation level to be deemed "highly compensated" under 414(q)(1)(B): $115,000 (no change); and
- Compensation level to be deemed "key" employee for top-heavy rules: $170,000 (increase of $5000).

The above discussion is intended to briefly summarize certain recent legal developments in employee benefits, but is not intended to be legal advice and must not be relied upon as such. All readers are urged to raise any concerns they may have based on matters discussed in this column with experienced benefits legal counsel.