

Employee 401h Benefits

From Fox Lalonde & Kenne

An IRC Section 401(h) Medical Expense Account Benefit

Frequently Asked Questions

What is a *medical expense account* under Code Section 401(h)?

A *medical expense account* under Code Section 401(h) is an account within a defined benefit pension plan for the payment of the sickness, accident, hospitalization, and medical expenses of retired employees and the spouses and dependents of retired employees. [Treas. Reg. §1.401-14(a)] The term *retired* for purposes of eligibility to receive medical benefits under Code Section 401(h) means that the employee is eligible to receive retirement benefits under the plan or is treated as retired by the employer by reason of the employee's permanent disability. An employee who must terminate employment with the employer as a condition of receiving retirement benefits is not considered retired. [Treas. Reg. §1.401-14(b)(1)]

When can I expect a 401(h) benefit to be available to me?

401(h) benefits are only available if you retire in the employ of this plan sponsor. There is no 401(h) benefit available prior to retirement.

What are the 401(h) benefits?

Post-retirement 401(h) benefits are made available to reimburse post-retirement medical expenses not otherwise covered by insurance or governmental programs, inclusive premiums and co-pays for medical and dental services, health insurance, long term care, etc.

See Exhibit A Benefits (attached hereto).

Your Section 401(h) account will specify the medical benefits that will be available and the provisions for determining the amount that will be paid. Furthermore, such benefits, when added to any life insurance protection provided under the defined benefit plan, must be subordinate to the retirement benefits provided by the plan.

See Benefit, Rights & Features - Aggregated Benefits (attached hereto).

Reasonable and ascertainable contributions. The contributions to fund medical benefits must be reasonable and ascertainable. The employer must, at the time it makes a contribution, designate the portion of the contribution allocable to funding medical benefits. [Treas. Reg. §1.401-14(c)(3)]

Impossibility of diversion prior to satisfaction of all liabilities. It must be impossible at any time prior to the satisfaction of all liabilities under the plan for any part of the corpus or income of the medical benefits account to be used for, or diverted to, any purpose other than providing medical benefits under the plan. The payment of necessary or appropriate expenses attributable to the administration of the medical benefits account, however, does not affect the qualification of the plan. [Treas. Reg. §1.401-14(c)(4)]

Reversion on satisfaction of all liabilities. The plan must provide that any amounts that are contributed to fund the 401(h) account and that remain in the account after satisfaction of all liabilities arising out of the operation of the Section 401(h) arrangement are returned to the employer. [Treas. Reg. §1.401-14(c)(5)]

Forfeiture. The plan must expressly provide that if an individual's interest in the medical benefits account is forfeited prior to termination of the plan, an amount equal to the amount of the forfeiture will be applied as soon as administratively possible to reduce employer contributions to fund the 401(h) account. [Treas. Reg. §1.401-14(c)(6)]

Sample List An IRC 401(h) Benefit Option

Sample list post-retirement medical benefits that may be provided under IRC Sec 105 & 106

Benefits are not limited to those contained in this list.

Acupuncture	Hospitalization Insurance
ADD Counseling and Assistance	Hospital Bills
Air Lift Transportation (Both US and Non US)	Insulin
Alcoholism	Laboratory Fees
Alternative Healthcare	Laetrile by Prescription
Alternative Medicines	Lasik Eye Surgery
Ambulance	Hire Lead Base Paid Removal-Children with Lead Poisoning
Artificial Limbs	Retirement Home for Medical Care
Artificial Teeth	Long Term Care, Nursing Homes
Assisted Living Facilities	Medical Information Plan
Asthma and Allergy Prevention and Treatment	Medicines
Birth Control Pills	Membership Fees for Medical Services, Hospitalization, Clinical Care, Health Maintenance, Health club memberships
Braces	Nurses Fees, Nurses Room and Board
Braille-Books and Magazines	Social Security Tax (Where Paid by Taxpayer)
Chiropractors	Obstetrical Expenses
Christian Science Practitioners' Fees	Operations (100% of All Costs)
Contact Lenses Including Examination Fee	Orthopedic Shoes
Co-Pays	Oxygen
Cosmetic Surgery (Even Though not by a Physician)	Personal Trainers
Cost for Care Outside the United States	Physical Therapy
Cost of Operations and Related Treatments	Physician Fees
Counseling	Premiums for LTC
Crutches	Preventive Care including but not limited to Spa Facilities, Usage Fees for Facilities
Deductibles	Prosthetics
Dental Cosmetic Surgery	Psychiatric Care
Dental Fees	Psychologist Fees
Dentures	"Seeing-eye" Dog and its Upkeep
Dependent Care	Specialists and Specialized Treatments
Dermatologist Care	Specially Equipped Cars
Diagnostic Fees	Special Care Costs for Disabled Dependents
Drugs	Special Diets
Electrolysis	Sterilization Fees
Experimental Care	Support Groups
Eyeglasses, Including Examination Fee, Laser Surgery for Vision Correction	Surgical Fees
Fees of Practical Nurse	Therapy Treatments
Fees for Healing Services	Transportation Expenses for Medical Services including Preventative Care
Fees of Chiropractors	Tuition Fee (part), if College or Private School Furnishes Breakdown of Medical Charges
Fees for Fitness Programs and Facilities	Tuition at Special School for Handicapped
Fees of Licensed Osteopaths	Viagra
Group Therapy	Vitamins
Handicap Persons' Special Schools	Wheelchair
Flu Shots	Weight Loss Programs
Hair Transplants	Wigs
Health Insurance Premiums	X-rays
Hearing Devices and Batteries	
Holistic Care	
Hospice	
In Home Care	

**Benefits, Rights and Features - Aggregated Benefits
IRC§1.401(a)(4)-4(d)(4); IRC§1.401(a)(4)-4(b) and IRC§1.401(a)(4)-4(c).**

Under §1.401(a)(4)-4(d)(4), an optional form of benefit, ancillary benefit, or other right or feature is permitted to be aggregated with another optional form of benefit, ancillary benefit, or other right or feature if one of the two is, in all cases, of inherently equal or greater value than the other, and the optional form of benefit, ancillary benefit, or other right or feature that is of inherently equal or greater value separately satisfies the current availability requirement of §1.401(a)(4)-4(b) and the effective availability requirement of §1.401(a)(4)-4(c).

For this purpose, one benefit, right, or feature is of inherently equal or greater value than another benefit, right, or feature only if, at any time and under any conditions, it is impossible for any employee to receive a smaller amount or a less valuable right under the first benefit, right, or feature than under the second benefit, right, or feature.

LAW AND ANALYSIS

Section 401(a)(4) provides that, under a qualified retirement plan, contributions or benefits provided under the plan must not discriminate in favor of highly compensated employees.

Section 410(b) provides minimum coverage requirements that are designed to ensure that a qualified plan provides sufficient benefits to a large enough proportion of participants who are non-highly compensated employees i.e. Average Benefits Test or Ratio % Test.

Section 1.401(a)(4)-1(b)(3) provides that a plan satisfies the requirements of §401(a)(4) only if all benefits, rights and features provided under the plan are made available under the plan in a nondiscriminatory manner.

Under §1.401(a)(4)-4(a), benefits, rights and features (i.e., optional forms of benefit, ancillary benefits, and other rights or features) are made available under the plan in a nondiscriminatory manner only if each benefit, right or feature satisfies the current availability requirement of §1.401(a)(4)-4(b) and the effective availability requirement of §1.401(a)(4)-4(c).

In general, a benefit, right or feature satisfies the current availability requirement of §1.401(a)(4)-4(b) for a plan year if the group of employees to whom the benefit, right or feature is currently available during the plan year satisfies §410(b) (without regard to the average benefit percentage test of §1.410(b)-5).

Another right or feature is any right or feature applicable to employees under the plan (other than a benefit formula, an optional form of benefit, or an ancillary benefit) that can be expected to have meaningful value. Under §1.401(a)(4)-4(e)(3)(i), a distinct other right or feature exists if a right or feature is not available on substantially the same terms as another right or feature.

Under § 1.401(a)(4)-4(e)(3)(iii)(C), the right to a particular form of investment, including, for example, a particular class or type of employer securities (taking into account, in determining whether different forms of investment exist, any differences in conversion, dividend, voting, liquidation preference, or other rights conferred under the security) is a distinct other right or feature.

Similarly, differences in insurance contracts (e.g., differences in cash value growth terms or different exchange features) that may be purchased from a plan can create distinct other rights or features even if the terms under which the contracts are purchased from the plan are the same.

To the extent the purchase from Plan A of a life insurance contract by a highly compensated employee is a distribution alternative with respect to benefits described in §411(d)(6)(A), such a purchase right is an optional form of benefit under Plan A.

Even in situations in which this purchase right is not an optional form of benefit, this purchase right is another right or feature. The purchase rights for the highly compensated employees are distinct optional forms of benefit or other rights or features from the purchase rights for non-highly compensated employees because of differences in the life insurance contracts (analogous to a conversion right applicable to a security).

This purchase right for highly compensated employees does not satisfy the current availability requirement of §1.401(a)(4)-4(b) because the right to purchase the contracts of a type available to the highly compensated employees is not available to any non-highly compensated employees, and therefore is not available to a group that satisfies the requirements of § 410(b).

Moreover, under the facts presented, this purchase right of highly compensated employees cannot satisfy the requirements of §1.401(a)(4)-4 through aggregation with any other optional form of benefit, ancillary benefit, or other right or feature (such as the purchase right for non-highly compensated employees) because no other optional form of benefit, ancillary benefit, or other right or feature under the plan that would enable the aggregated benefits to be available to a group that satisfies the requirements of §410(b) is of inherently equal or greater value. Thus, Plan A fails to satisfy the nondiscrimination requirements of § 401(a)(4).

HOLDING

A plan that is funded, in whole or in part, with life insurance contracts does not satisfy the requirements of §401(a)(4) prohibiting discrimination in favor of highly compensated employees where: (1) the plan permits highly compensated employees, prior to distribution of retirement benefits, to purchase those life insurance contracts prior to distribution; and (2) any rights under the plan for non-highly compensated employees to purchase life insurance contracts from the plan prior to distribution of retirement benefits are not of inherently equal or greater value than the purchase rights of highly compensated employees.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Larry Isaacs of Employee Plans, Tax Exempt and Government Entities Division, and Linda Marshall of the Office of the Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities. For further information regarding this revenue ruling, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday, by calling (877) 829-5500 (a toll-free number). Mr. Isaacs may be reached at (202) 283-9710, and Ms. Marshall may be reached at (202) 622-6090 X 5 (not toll-free numbers).