CARLTON FIELDS

Employee Benefits: A Potpourri of Current Benefit Issues

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The IRS continues to be busy on a lot of fronts, and while I issued past alerts on some items and gave a webinar or two on others, there is more to discuss! Rather than focus on a single issue and explanation as I normally do, the following is a list of items of which you should be aware. Each item begins with the type of employer or benefit at issue:

- **Employers sponsoring group health plans with employees who received an insurance subsidy in 2015 and/or are receiving a subsidy now:**
  The IRS is issuing letters assessing ACA penalties for 2015, while the Department of Health & Human Services ("HHS") is issuing letters to notify employers that because at least one employee is currently receiving a subsidy, the employer may be liable for penalties for 2016. An employer should seriously consider responding to either of these letters, but recognize that a letter from HHS is not assessing penalties, as that is the IRS' role.

- **Defined benefit plans:**
  The IRS reminded employers that when a defined benefit plan establishes book accounts and allocates actual earnings on certain amounts in those accounts, the plan may need to be drafted and administered as if the defined contribution rules apply. This guidance was focused on governmental defined benefit plans that allocate actual earnings and losses to "deferred retirement option programs" ("DROPs"). The guidance makes allowances for certain DROPs, but another common governmental plan feature – the "share plan" may trigger these additional requirements even if the DROP does not. The IRS also expressed concerns, and generally required amendments, addressing how fees were allocated to these individual accounts.

- **Governmental and nonprofit 457s:**
  The IRS issued proposed regulations on 457(b) and (f) plans, that mainly takes guidance they issued in various notices and other rulings and relocates them into formal regulations. This may indicate that the IRS believes many 457 plans have not been following all applicable requirements, making a review of your 457 plan a good idea. This guidance also touched upon a tax issue created by allowing certain cashouts of unused leave (discussed below).

- **Employers who allow cashouts of unused sick, vacation, or other leave prior to termination of employment:**
  Does your entity allow unused leave to rollover to later years? Do you allow active employees to choose whether to (i) use the leave as paid leave, (ii) roll the leave over to the next year, or (iii) receive a cash payment for all or a portion of that leave? If so, you probably have a tax problem because employees who choose to rollover leave to later years should still be taxed on the value of the leave they could have cashed out. This concept is called constructive receipt. This is not a new issue, but IRS guidance issued on 457 plans (above) mentions this, and notes that the IRS may take the position that an employer with an arrangement like this is operating an improper salary deferral

- **Individually designed retirement plans(defined benefit, defined contribution, 401(k), profit sharing, cash balance pension equity, and money purchase pension plans):**
  If your retirement plan is "individually designed," as opposed to being an IRS preapproved "prototype" or "volume submitter" document, it is important to know that the IRS is changing the favorable determination letter program and the requirements governing the timing of future required amendments. While this is not triggering an immediate impact, it is creating some uncertainty and you may want to assess whether your plan can be restated onto an IRS pre-approved document, for which the amendment requirements are not changing. If you do not know whether your plan is preapproved by the IRS, ask the entity who drafted your plan if it has an "IRS opinion letter," and obtain a copy if it does. An opinion letter means it was preapproved; if it does not have an opinion letter, it is an individuallydesigned plan.
  - Retirement plans with mandatory employee contributions: IRS guidance clarifies that any opportunity or election given to active employees that could have the effect of changing their level of pretax mandatory contributions violates the Internal Revenue Code. Generally, we only see governmental retirement plans use mandatory employer contributions, and common ways this issue can arise are as follows:

  - Active employees are given a 1time opportunity to change their mandatory pretax contribution rate from its current percentage to a higher or lower percentage;

  - Active employees are given an opportunity to switch from a retirement plan with 1 level of mandatory employee contributions to another plan that has a different level of mandatory employee contributions; and

  - A plan with mandatory employee contributions allows employees of a certain rank (normally police or fire chiefs) to opt out of the plan altogether, and this provision is applied to allow an active employee who has been making mandatory employee contributions to opt out of the plan and cease making (or altering) those contributions

- **Governmental defined benefit plans and money purchase pension plans (which are sometimes called "401(a) plans" and sometimes called "defined contribution plans") that allow inservice distributions prior to age 62:**
  IRS guidance clarifies that such plans must have a proper normal retirement age ("NRA"). The NRA can be any age that is representative of when people generally retire, industry-wide, but this IRS guidance is very generous in expressing what will automatically be deemed as a proper NRA, automatically allowing NRAs at age 62 (50 for special risk employees); age 60 with 5 years of service ("YOS"); age 55 with 10 YOS; anyone with a combined age and YOS that total 80 years (70 for special risk employees); or 25 YOS (20 for special risk employees) regardless of age. In addition to these relatively generous NRAs that are automatically permissible, the IRS is allowing this guidance to only apply to employees hired in 2017, and only if the plan allows inservice distributions prior to age 62.

- **Employers that allow employees to terminate employment in order to access retirement funds, with the understanding that the employee will be rehired later:**
  We generally only see this with governmental retirement plans, as they are traditionally more restrictive with distributions to active employees (called "inservice distributions"). The IRS will ignore a termination of employment if there is an understanding that an employee will be rehired later, making any distribution issued to that "former" employee an "inservice distribution" that will violate the terms of the plan if the plan does not permit inservice distributions. The easiest ways to address this are to eliminate the incentive for employees to do this by allowing certain inservice distributions, or revising policies to prevent pre-arranged rehires. This issue is not new, but in light of IRS guidance on NRA that is tied to inservice contributions, we thought this reminder was appropriate. For example, if a governmental plan document does not allow inservice distributions, and one department allows an employee to terminate employment at age 60, elect to receive a full or partial distribution of retirement benefits, and then be rehired, the IRS will (i) view that distribution as an inservice distribution that violated the terms of the plan document, and (ii) hold that this plan, operationally, allows inservice distributions prior to age 62 and, as such, must comply with the NRA regulations described above.

For more information, please contact the Carlton Fields attorney with whom you usually work, or the author of this Legal News Alert.

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