

# Employee Benefit Plans

## Explanation

### No. **13**

#### **Section 401(h) Determination of Qualification**

The purpose of Worksheet Number 13 (Form xxxxx) and this explanation is to identify major problems with respect to the requirements of Internal Revenue Code section 401(h) in plans with retiree medical benefit features. However, there may be issues not mentioned in the worksheet that could affect the plan's qualification.

This worksheet is to be completed if the applicant has specifically requested consideration of either section 401(h) or section 420, relating to transfers of assets in a defined benefit plan to a section 401(h) medical benefits account.

Generally, a "Yes" answer to a question on the worksheet indicates a favorable conclusion while a "No" answer signals a problem concerning the plan qualification. This rule may be altered by specific instructions for a given question. Please explain any "No" answer in the space provided on the worksheet.

The sections cited at the end of each paragraph of explanation are to the Internal Revenue Code and the Income Tax Regulations.



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## I. BENEFITS

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**Line a, b.** When a determination under section 420 on the transfer of excess assets to retiree health accounts has been requested, the plan must contain provisions that meet the requirements of section 401(h) in order for the plan to meet section 420.  
*Section 420(e)(3).*

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**Line c, d.** A pension or annuity plan may provide retiree medical benefits, through a section 401(h) account, including payment of benefits for sickness, accident, hospitalization and medical expenses. The plan must specify the medical benefits described in section 401(h) which will be available and must contain provisions for determining the amount which will be paid. Other benefits may not be provided from a qualified account under section 401(h). The requirements of section 401(h) must be met with respect to any retiree medical account under a pension or annuity plan for such plan to qualify under sections 401(h) and section 401(a).  
*Section 401(h); Treas. Regs. 1.401-1(b)(1)(i), 1.401-14(a) and (c)(1).*

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**Line e.** The plan must provide that medical benefits are only provided for retired employees, their spouses and dependents. To be "retired" for purposes of eligibility to receive medical benefits described in section 401(h), an employee must be eligible to receive retirement benefits provided under the pension plan, or else be retired by an employer providing such medical benefits by reason of permanent disability. For purposes of the preceding sentence, an employee (even one who is past normal retirement age) is not considered to be "eligible to receive retirement benefits provided under the plan" if he is still employed by the employer and a separation from employment is a condition for receiving the retirement benefits.

Although the specific requirements of sections 1.401(a)(4)-1 through -13 of the regulations directly apply to the retirement portion of a plan that provides medical benefits described under section 401(h), the portion of the plan that is providing the medical benefits described under section 401(h) must not discriminate in favor of highly compensated employees with respect to coverage and with respect to the contributions or benefits.  
*Section 401 (h); Treas. Regs. 1.401-14(a), (b) (1) and (2) and 1.401(a)(4)-1(c)(14).*

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**Line f.** Contributions to provide the medical benefits described in section 401(h) may be made either on a contributory or noncontributory basis, without regard to whether the contributions to fund the retirement benefits are made on a similar basis. Thus, for example, the contributions to fund the medical benefits may be

provided for entirely out of employer contributions even though the retirement benefits under the plan are determined on the basis of both employer and employee contributions or vice versa.  
*Treas. Reg. 1.401-14(h)(3).*

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## II. SUBORDINATION

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**Line a.** This requirement was codified in section 401(h) by the Omnibus Budget Reconciliation Act of 1989. The plan section or plan amendment adopting the medical benefits account should be reviewed to ensure that the plan language specifically provides that only contributions after the later of the adoption date or the effective date are considered for the subordination test. If the plan section or plan amendment references an effective date prior to the date the medical benefits account was established (the adoption date), the plan should be amended to reflect a date which is the later of the adoption date or the effective date.

Under the subordination limitation, past service amortizations and life insurance protection reduce the amount that may be contributed to the medical benefits account.

Life insurance protection includes any benefit paid under the plan on behalf of an employee-participant as a result of the employee-participant's death to the extent such payment exceeds the amount of the reserve to provide retirement benefits existing at his death.

(Treas. Reg. 1.401-14(c)(1) has not been revised to reflect the changes made by OBRA '89.)  
*Section 401(h)(1) and Treas. Reg. 1.401-14(c)(1)(i).*

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## III. SEPARATE ACCOUNTS

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**Line a.** Where medical benefits described in section 401(h) are provided for under a qualified pension or annuity plan, the plan must provide that a separate account must be established and maintained with respect to contributions to fund such benefits. The separation required by this section is for recordkeeping purposes only. Consequently, the funds in the medical benefits account need not be separately invested.  
*Section 401(h)(2) and Treas. Reg. 1.401-14(c)(2).*

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**Line b, c.** Key employees.  
*Section 401(h)(6).*

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#### IV. REASONABLE AND ASCERTAINABLE PROVISIONS

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**Line a, b.** The contributions for medical benefits provided by the section 401(h) account must be reasonable and ascertainable, and the plan must contain provisions for determining the amount which will be paid. These requirements will not be satisfied unless the terms of the plan specify the amount of benefits and the time period with respect to which benefits will be paid. Where there are other potential sources of payment of medical benefits such as a welfare benefit fund or the general funds of the employer, the plan must be specific as to how the benefits payable from the section 401(h) account are coordinated with benefits payable from other sources. The plan may not allow for employer discretion in the timing and amount of benefit payments. The employer must, at the time a contribution is made, designate that portion of such contribution allocable to the funding of medical benefits.  
*Section 401(h)(3) and Treas. Reg. 1.401-14(c) (1) and (3).*

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#### V. MISCELLANEOUS

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**Line a.** A plan which, for example, under its terms, permits funds in the retiree medical benefits account to be used for any retirement benefit provided under the plan does not satisfy the requirements of section 401(h) and will not qualify under section 401(a). However, the payment of any necessary or appropriate expenses attributable to the administration of the medical benefits account does not affect the qualification of the plan.  
*Section 401(h)(4) and Treas. Reg. 1.401-14(c)(4).*

**Line b.** The plan must expressly provide that any amounts that are contributed to fund medical benefits described in section 401(h) and that remain in the medical benefits account upon the satisfaction of all liabilities arising out of the operation of the medical benefits portion of the plan are to be returned to the employer.  
*Section 401(h)(5) and Treas. Reg. 1.401-14(c)(5).*

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**Line c.** Medical account forfeitures.  
*Treas. Reg. 1.401-14(c)(6)*