

Employee Benefit Plans

Explanation No. 13 Section 401(h) and Section 420 Determination Of Qualification

Note:

Plans submitted during the Cycle A submission period must satisfy the applicable changes in plan qualification requirements listed in Section IV of Notice 2015-84, 2015-52 I.R.B. 1 (the 2015 Cumulative List).

This publication contains copies of:
Form 13069, Worksheet 13
Form 13070, Deficiency Checksheet 13

These forms are included as examples only and should not be completed and returned to the Internal Revenue Service.

The purpose of Worksheet Number 13 (Form 13069) 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 and on plan provisions enabling the transfer of assets in a defined benefit plan to a health benefit account described in section 401(h), pursuant to section 420. 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 or to an applicable life insurance account under section 420(e)(4).

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.

The technical principles in this publication may be changed by future regulations or guidelines.



I. Retiree Medical Benefits

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, including a health benefits account, that meet the requirements of section 401(h) in order for the plan to comply with section 420.

Section 420(e)(3)

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).

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).

Line f. Contributions to provide the medical benefits described in section 401(h) may either include or exclude employee contributions, 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.

II. Subordination – Retiree Medical Benefits

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 to the pension plan after the later of the adoption date or the effective date are considered when determining the maximum amount that can be contributed to the 401(h) medical benefits account under 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, employer contributions to the pension plan to fund past service amortizations are disregarded when determining the maximum amount that can be contributed to the 401(h) medical benefits account under the subordination rule, and amounts paid for 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. Life insurance protection also excludes any amounts transferred to or paid from an applicable life insurance account described in section 420(e)(4). (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).

III. Separate Accounts – Retiree Medical Benefits

Line a. Where medical benefits described in section 401(h) are provided 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).

Line b, c. Separate accounts must also be established and maintained for each key employee (and his or her spouse and dependents) for whom medical benefits described in section 401(h) are provided under a qualified pension or annuity plan. The separation required by this section is for recordkeeping purposes only, and the funds in these accounts for key employees need not be separately invested.

Section 401(h)(6).

IV. Reasonable And Ascertainable Provisions – Retiree Medical Benefits

Line a. 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).

V. Miscellaneous – Retiree Medical Benefits

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).

Line c. The plan must expressly provide that, in the event an individual's interest in any amounts contributed to a 401(h) medical benefits account is forfeited before the plan terminates, an amount equal to the amount of the forfeiture must be applied as soon as possible to reduce employer contributions to fund the medical benefits.

Treas. Reg. 1.401-14(c)(6).

VI. Applicable Life Insurance Benefits

Line a, b. When a determination under section 420 on the transfer of excess assets to an applicable life insurance benefits has been requested, the plan must contain provisions that meet the requirements of section 420.

Sections 420(a)(1) and 420(e)(4).

Line c, d. After July 6., 2012, a pension or annuity plan may transfer excess assets to an applicable life insurance account under section 420 to provide payment of benefits for group-term life insurance coverage for retirees who are entitled to receive such coverage by reason of retirement, but only to the extent that such coverage is provided under a policy for retired employees and the cost of such coverage is excludable from the retired employee's income under section 79. The plan must specify the benefits which will be available and must contain provisions for determining the premiums which will be paid. Other benefits may not be provided from an applicable life insurance account.

Section 420(c)(1).

Line e. The plan must provide that applicable life insurance premiums are only provided for retired employees. To be "retired" for purposes of eligibility for applicable life insurance benefits described in section 420(e)(1)(D), an employee must be eligible to receive retirement benefits provided under the pension plan. 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.

Line f. Section 401(h) does not provide for employee or employer contributions to fund applicable life insurance benefits. These benefits are only available if a transfer is made to an applicable life insurance account under section 420.

Sections 401(h) and 420.

VII. Separate Account – Applicable Life Insurance Benefits

Line a. Where applicable life insurance benefits described in section 420(e)(1)(D) are provided 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 420(e)(4).

Line b, c. Benefits for key employees (as defined in section 416(i)) cannot be included in amounts transferred to applicable life insurance accounts or in life insurance premiums paid from applicable life insurance accounts.

Sections 420(c)(1), 420(e)(D), and 420(e)(1)(E).

VIII. Additional Provisions For Section 420 Transfers

Line a, b. If excess pension assets are transferred to a 401(h) medical benefits account or an applicable life insurance account under section 420, the plan must provide that the accrued pension benefits of any participant or beneficiary under the plan become nonforfeitable in the same manner which would be required if the plan had terminated immediately before the qualified transfer (or, in the case of a participant who separated during the 1-year period ending on the date of the transfer, immediately before such separation).
Section 420(c)(2).

Line c,d. Any assets transferred to a 401(h) medical benefits account or an applicable life insurance account which are not used to pay qualified current retiree liabilities (other than liabilities of key employees) for the taxable year of the transfer (whether directly or through reimbursement) shall be transferred out of the account to the transferor plan.

In the case of a qualified future transfer or collectively bargained transfer to which section 420(f) applies, any assets transferred to the 401(h) medical benefits account or applicable life insurance account may also be used to pay benefits described in section 420(f)(2). However, section 420(f)(2)(B)(ii) states that if the plan's funded status falls below specified levels, either the employer maintaining the plan must make a contribution to the plan or amounts must be transferred from the 401(h) medical benefits account or the applicable life insurance account to restore the plan's funded status.
Section 420(f)(2)(B).

Employee Benefit Plan
Sections 401(h) and 420
(Worksheet Number 13 – Determination of Qualification)

Instructions – All items must be completed. A “Yes” answer generally indicates a favorable conclusion is warranted, while a “No” answer indicates a problem exists. Please use the space on the worksheet to explain any “No” answer. Numbers in brackets refer to EDS paragraph numbers. See Publication 11433, Explanation Number 13, for guidance in completing this form.

The technical principles in this worksheet may be changed by future regulations or guidelines.

Name of plan

I. Retiree Medical Benefits	Plan Reference	Yes	No	N/A
a. Has the applicant requested consideration under section 401(h) or 420 relative to retiree medical benefits? (If “Yes,” see section 16 and appendix of Rev. Proc. 2015-6, 2015-1 I.R.B. 194, and complete the remainder of this worksheet. If “No,” go to section VI of this worksheet.) [1375]				
b. Does the plan contain a medical benefits account within the meaning of section 401 (h)? (If “Yes,” complete the remainder of this worksheet. If “No,” secure amendments to include the section 401(h) account provisions or request an explanation from the applicant and go to Section VI of this worksheet.) [1375]				
c. Is the section 401(h) medical benefits account part of a pension or annuity plan (including a money purchase pension plan)? [1376]				
d. Does the plan specify the medical benefits that will be available and contain provisions for determining the amount that will be paid? [1376]				
e. Does the medical benefits account specify who will benefit and limit eligible persons to retired employees, their spouses and their dependents? [1377]				
f. Does the plan specify either that contributions to the medical benefits account are provided entirely from employer contributions or that they will be paid from employer and employee contributions? [1378]				
II. Subordination – Retiree Medical Benefits	Plan Reference	Yes	No	N/A
a. Does the plan provide that retiree medical benefits are subordinate to the retirement benefits such that the aggregate actual contributions for medical benefits, when added to actual contributions for life insurance protection under the plan (excluding any amounts transferred to or paid from an applicable life insurance account, if applicable), do not exceed 25 percent of the total actual contributions to the plan (other than contributions to fund past service credits) after the later of the adoption or effective date of the plan amendment establishing the section 401(h) account? [1379]				
III. Separate Accounts – Retiree Medical Benefits	Plan Reference	Yes	No	N/A
a. Does the plan provide that the section 401(h) arrangement for retiree medical benefits is a separate account established and maintained for such benefits? [1380]				
b. Does the plan provide that in the case of an employee who is a key employee, a separate account is established and maintained for retiree medical benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his spouse and dependents) from such separate account? [1381]				
c. Does the plan provide that the term “key employee” means any employee, who at any time during the plan year or any preceding plan year during which contributions were made on behalf of such employee, is or was a key employee as defined in section 416(i)? [1381]				
IV. Reasonable and Ascertainable Provisions – Retiree Medical Benefits	Plan Reference	Yes	No	N/A
a. Does the plan provide for employer contributions to the medical benefits account that are reasonable and ascertainable? [1382]				

V. Miscellaneous – Retiree Medical Benefits	Plan Reference	Yes	No	N/A
a. Does the plan provide that it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide section 401(h) medical benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits? [1383]				
b. Does the plan expressly provide that, notwithstanding the provisions of section 401(a)(2), upon the satisfaction of all liabilities under the plan to provide section 401(h) medical benefits, any amount remaining in such separate account must be returned to the employer? [1384]				
c. Does the plan expressly provide that, in the event 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 must be applied as soon as possible to reduce employer contributions to fund the medical benefits? [1385]				
VI. Applicable Life Insurance Benefits	Plan Reference	Yes	No	N/A
a. Has the applicant requested consideration under section 420 relative to applicable life insurance benefits? (If "Yes," see section 420, and complete the remainder of this worksheet. If "No," go to section VIII of this worksheet.) [1386]				
b. Does the plan contain an applicable life insurance account within the meaning of section 420? (If "Yes," complete the remainder of this worksheet. If "No," secure amendments to include the applicable life insurance account provisions or request an explanation from the applicant.) [1387]				
c. Is the applicable life insurance account part of a pension or annuity plan (including a money purchase pension plan)? [1388, 1389]				
d. Does the plan specify the life insurance benefits that will be available and contain provisions for determining the premiums that will be paid? [1388, 1389]				
e. Does the applicable life insurance account specify who will benefit and limit eligible persons to retired employees who are entitled to group-term life insurance coverage by reason of retirement, but only to the extent that such coverage is provided under a policy for retired employees and the cost of such coverage is excludable from the retired employee's gross income under section 79 of the Code? [1390]				
f. Does the plan specify that the applicable life insurance account will be funded by means of transfers of excess pension assets in accordance with section 420, and that no employer or employee contributions will be made to such account? [1391]				
VII. Separate Account – Applicable Life Insurance Benefits	Plan Reference	Yes	No	N/A
a. Does the plan provide that the section 420 applicable life insurance account is a separate account established and maintained for such benefits? [1392]				
b. Does the plan provide that the 420 applicable life insurance account is not to be used to pay life insurance premiums for an employee who is a key employee? [1393, 1394]				
c. Does the plan provide that the term "key employee" means any employee, who at any time during the plan year during which applicable life insurance premiums are paid or any preceding plan year was a key employee as defined in section 416(i)? [1393, 1394]				
VIII. Additional Provisions for Section 420 Transfers	Plan Reference	Yes	No	N/A
a. Has the applicant requested consideration for a transfer under section 420 with respect to either retiree medical benefits or applicable life insurance benefits? (If "Yes," complete the remainder of this worksheet. If "No," do not complete the remainder of this worksheet.) [1395]				
b. Does the plan provide that for any participant or beneficiary under the plan, the benefits that had accrued before a transfer to a 401(h) medical benefits account or an applicable life insurance account become nonforfeitable to the extent required under section 420(c)(2)? [1396]				

VIII. Additional Provisions for Section 420 Transfers – Continued	Plan Reference	Yes	No	N/A
c. Does the plan expressly provide that, except as provided in section 420(f) for collectively bargained transfers, any assets transferred to a health benefits account or applicable life insurance account (and any income allocable thereto) will be returned to the transferor plan to the extent they are not used to pay qualified current retiree medical or life insurance benefits, respectively, for the taxable year of the transfer (in the case of a qualified transfer under section 420(b)(1)) or to the extent needed to comply with the requirement to maintain the plan's funded status under section 420(f)(2)(B) (in the case of a qualified future transfer under section 420(f)(2)(A))? [1397]				
d. In the case of a collectively bargained plan, does the plan expressly provide that any collectively bargained transfers described in section 420(f)(2)(E) to a 401(h) medical benefits account or applicable life insurance account are only to be used to pay benefits for collectively bargained liabilities as described in section 420(f)(6)(B), and will be returned to the transferor plan to the extent needed to comply with the requirement to maintain funded status under section 420(f)(2)(B)? [1398]				

This form is provided as an example only and should not be completed or returned to the Internal Revenue Service.

Employee Plan Deficiency Checksheet
Attachment Number 13
Sections 401(h) and 420

For IRS Use	Please furnish the amendment(s) requested in the section(s) checked below.
1375 I.a., b.	For a section 420 transfer of excess assets to retiree health accounts, the plan must be amended to include provisions for a medical benefits account within the meaning of section 401(h). IRC section 420(e)(3).
1376 I.c., d.	A pension or annuity plan containing a section 401(h) account may only provide medical benefits including payment of benefits for sickness, accident, hospitalization and medical expenses. Section _____ of the plan should be amended to specify the medical benefits that will be available, the amount that will be paid and when the payments will occur. IRC section 401(h); Treasury Regs. 1.401-1(b)(1)(i); 1.401-14(a) and (c)(1).
1377 I.e.	Section _____ of the plan should be amended to specify who is eligible to receive medical benefits from the section 401(h) account. Note that benefits may only be provided to retired employees, their spouses and their dependents. IRC section 401(h); Treasury Regs. 1.401-14(a), (b)(1) and (b)(2).
1378 I.f.	Section _____ of the plan should be amended to provide whether contributions to the section 401(h) account are provided entirely from employer contributions or whether they will be paid from employer and employee contributions. Treasury Reg. 1.401-14(b)(3).
1379 II.a.	Section _____ of the plan should be amended to provide that the aggregate actual contributions for retiree medical benefits, when added to the actual contributions for life insurance under the plan (excluding amounts transferred to or paid from any applicable life insurance account), are limited to 25 percent of the total actual contributions made to the plan (other than contributions to fund past service credits) after the later of the adoption or effective date of the section 401(h) arrangement (note that the date of adoption is the date the employer signs or executes the section 401(h) amendment). IRC section 401(h); Treasury Reg. 1.401-14(c)(1)(i).
1380 III.a.	Section _____ of the plan should be amended to provide that a separate account is established and maintained with respect to contributions to fund medical benefits under the section 401(h) arrangement. IRC section 401(h)(2); Treasury Reg. 1.401-14(c)(2).
1381 III.b., c.	Section _____ of the plan should be amended to provide that in the case of an employee who is a key employee (as defined in IRC section 416(i)), a separate account is established and maintained for medical benefits payable to such employee (and his or her spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his or her spouse and dependents) from such separate account. IRC section 401(h)(6).
1382 IV.a.	Section _____ of the plan should be amended to provide that the employer's contributions to the medical benefits account are reasonable and ascertainable and that the employer must, at the time a contribution is made, designate that portion of such contribution allocable to the funding of medical benefits. In addition, section _____ of the plan should be amended to specify the amounts of benefits, the priority and the time period with respect to which benefits will be paid from each source, when other sources of payment for such medical benefits exist, such as a welfare benefit fund (for example, a section 501(c)(9) voluntary employees beneficiary association) or the general funds of the employer. IRC section 401(h)(3); Treasury Reg. 1.401-14(c)(1) and (3).
1383 V.a.	Section _____ of the plan should be amended to provide that it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide section 401(h) medical benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits. IRC section 401(h)(4); Treasury Reg. 1.401-14(c)(4).
1384 V.b.	Section _____ of the plan should be amended to provide, notwithstanding the provisions of section 401(a)(2), that upon the satisfaction of all liabilities under the plan to provide section 401(h) medical benefits, any amount remaining in such separate account must be returned to the employer. IRC section 401(h)(5); Treasury Reg. 1.401-14(c)(5).
1385 V.c.	Section _____ of the plan should be amended to provide that in the event 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 must be applied as soon as possible to reduce employer contributions to fund the medical benefits. Treasury Reg. 1.401-14(c)(6).
1387 VI.b.	For a section 420 transfer of excess assets to applicable life insurance health accounts, the plan must be amended to include provisions for an applicable life insurance account within the meaning of section 420(e)(4).

1388, 1389 VI.c., d.	A pension or annuity plan containing an applicable life insurance account may only provide group-term life insurance coverage for retired employees, to the extent that such coverage is provided under a policy for retired employees and the cost of such coverage is excludable from the retired employee's gross income under section 79 of the Code. Section _____ of the plan should be amended to specify the applicable life insurance benefits that will be available, the premiums that will be paid and when the payments will occur. IRC section 420(e)(1)(D).
1390 VI.e.	Section _____ of the plan should be amended to specify who is eligible to have applicable life insurance premiums paid on their behalf from the applicable life insurance account. Note that life insurance premiums may only be paid for retired employees, who, immediately before the qualified transfer, are entitled to receive such coverage by reason of retirement. IRC section 420(e)(1)(D).
1391 VI.f.	Section _____ of the plan should be amended to provide that the applicable life insurance account will be funded by means of transfers of excess pension assets in accordance with section 420, and that no employer or employee contributions will be made to such account. IRC Sections 401(h) and 420(e)(4).
1392 VII.a.	Section _____ of the plan should be amended to provide that a separate account is established and maintained with respect to transfers to fund applicable life insurance benefits under section 420. IRC section 420(e)(4).
1393, 1394 VII.b., c.	Section _____ of the plan should be amended to provide that the applicable life insurance account is not to be used to pay premiums for an employee who is a key employee (as defined in IRC section 416(i)). IRC sections 420(c)(1), 420(e)(1)(D) and 420(e)(1)(E).
1395 VIII.a., b.	Section _____ of the plan should be amended to provide that for any participant or beneficiary under the plan, benefits that had accrued before a transfer to a 401(h) medical benefits account or applicable life insurance account become nonforfeitable to the extent required under section 420(c)(2). IRC section 420(c)(2).
1397 VIII.c.	Section _____ of the plan should be amended to provide that (except as provided under section 420(f) for collectively bargained transfers), any assets transferred to a 401(h) medical benefits account or applicable life insurance account (and any income allocable thereto) will be returned to the transferor plan to the extent they are not used to pay qualified current retiree medical or life insurance benefits, respectively, for the taxable year of the transfer (in the case of a qualified transfer under section 420(b)(1)) or to the extent needed to comply with the requirement to maintain the plan's funding status under section 420(f)(2)(B) (in the case of a qualified future transfer under section 420(f)(2)(A)). IRC section 420(c)(1)(B).
1398 VIII.d.	Section _____ of the plan should be amended to provide that collectively bargained transfers described in section 420(f)(2)(E) to a 401(h) medical benefits account or an applicable life insurance account are only to be used to pay benefits for collectively bargained liabilities as described in section 420(f)(6)(B), and any amounts not so used will be returned to the transfer plan to the extent required under section 420(f)(2)(B). IRC section 402(f)(2).