



HR and Benefits Update

November-December, 2010

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Health Care Reform Requires Plan Document Changes

For the past several months, employers have been learning about health care reform and trying to put all the pieces in place to be in compliance. That means most employers will need to amend their plan documents very soon.

Section 125 Plans

Section 125 (or cafeteria plan) documents need to be amended to reflect the tax-free employer-provided health coverage now available for children who are under the age of 27 as of the end of the taxable year. For this purpose, the term “children” includes children, stepchildren, legally adopted children, children placed with the employee for adoption, and eligible foster children.

The cafeteria plan treatment for children under the age of 27 is not automatic. The cost of employer-provided accident or health coverage may be excluded from the employee’s gross income retroactively to March 30, 2010. However, the IRS clarified in Notice 2010-38 that the plan document must be amended no later than Dec. 31, 2010, to specifically permit pre-tax salary reduction elections for children under the age of 27.

Health Care Reform Requires Plan Document Changes *continued*

The amended definition of “children” for purposes of tax-free health coverage is extended to medical expenses reimbursed under Flexible Spending Accounts (FSAs) and Health Reimbursement Arrangements (HRAs), but not under Health Savings Accounts (HSAs). Additionally, premiums paid for excepted benefits, such as stand-alone dental and vision policies, are now available on a tax-free basis for children meeting this definition.

This amended definition of eligibility for tax-free health coverage is separate from the requirement to provide major medical coverage to an adult child until age 26. For this purpose, a plan can no longer take into account factors such as residency, financial dependence or student status. Also, a plan can no longer take into account the dependent’s eligibility for health coverage under their own employer or a spouse’s employer, unless the plan is considered grandfathered. A plan is not required to provide stand-alone dental or vision coverage to an adult child until age 26, but if they do, the premiums may be paid tax-free.

FSAs, HRAs and HSAs

Health care reform made changes to the reimbursement rules for FSAs, HRAs and HSAs. Beginning on Jan. 1, 2011, over-the-counter (OTC) drugs will no longer be reimbursable on a tax-free basis for these plans. Other OTC non-drug items, such as bandages and crutches, remain eligible expenses. In addition, debit cards can no longer be used to purchase non-reimbursable drugs; the cards must be reprogrammed no later than Jan. 15, 2011, so that the debit cards cannot be used to purchase OTC drugs. Cafeteria plan sponsors have until June 30, 2011, to amend their plans to conform to these new restrictions, as long as the amendment is effective retroactively for expenses incurred after Dec. 31, 2010, or after Jan. 15, 2011 for debit card purchases.

Summary Plan Descriptions

Finally, summary plan descriptions will need to be amended. Model notices have been released for many of the changes, but for some employers, legal counsel or a third-party administrator will be needed to create the language.

Changes to consider may include: an updated definition of an eligible dependent; change due to annual limits or the removal of lifetime limits; pre-existing condition exclusions; prohibitions on rescissions; preventive health services, the appeals process and external review; and grandfathered status (or lack thereof). In addition, employers who have voluntarily implemented certain provisions of health care reform early, such as providing coverage for young adults until age 26 in advance of the first plan year after Sept. 23, 2010, should consult with legal counsel about whether a plan amendment is needed for this purpose.

In addition, employers should remember that under ERISA, a summary of any plan changes must be sent to participants explaining the changes in plain language so that the average participant can understand those changes.

Most plan sponsors will need to amend their plan documents soon to comply with health care reform. In addition, employers need to have processes in place, update policies and effectively communicate these changes to employees.

If you would like more information about these requirements or would like to be provided with the model notices mentioned, please contact your advisor.

Small Business Jobs Act of 2010: Changes to Roth Rules

On Sept. 27, 2010, the Small Business Jobs Act of 2010 (SBJA '10) was signed into law. The new law significantly expands the potential use of Roth philosophy within the retirement plan landscape. Beginning in 2010 new rules allowed employees eligible to receive a distribution to rollover amounts from their retirement plans – 401(k), 403(b) or governmental 457(b) – to a Roth IRA. These new rules also allowed employees to defer the tax due on such rollovers into 2011 and 2012. But the new rules didn’t allow participants to convert pre-tax dollars to Roth dollars within their existing retirement plans. Moreover, the new rules allowed rollovers to Roth IRAs, but, unlike most retirement plans, the Roth IRA has income eligibility requirements that many employees may not have met, thus denying them the ability to convert their retirement savings from pre-tax to Roth. SBJA '10 addresses these issues, as well as expands the type of plans that can provide a Roth account to employees.

The new law permits plan participants to leave their money in their retirement plan, but convert it from pre-tax to Roth if certain facts and circumstances exist. First, the plan document has to allow for Roth contributions. The participant must have experienced a distributable event under the terms of the plan, thus conversion is not necessarily available to every plan participant. To allow more access for pre-tax-to-Roth conversions, plan documents should be amended to allow for in-service withdrawals (if they do not allow for such at present).

Small Business Jobs Act of 2010: Changes to Roth Rules *continued*

Also, a participant's ability to defer taxation provided for rollovers to Roth IRAs has been extended to in-plan conversions that occur within 2010. In other words, if a plan allows, and a participant converts pre-tax dollars to Roth dollars in 2010, they are allowed to defer taxation into 2011 and 2012. Thus, if an employer wishes to provide this flexibility to their participants, it behooves them to take action (amend plans, discuss with recordkeeper/administrator/TPA, communicate to participants, etc.) sooner rather than later. In addition, the SBJA '10 authorizes state or local government 457(b) plans to include Roth accounts, effective for plan years beginning after Dec.31, 2010.

If you have any questions regarding this legislation, or wish to discuss making changes to your plan, contact your plan consultant.

Compliance FAQ

Question: What is a summary annual report and how does it need to be distributed?

Answer: Most employers are aware that an ERISA plan administrator must file an annual report (Form 5500) with the U.S. Department of Labor's Employee Benefits Security Administration. Equally important for employers, however, is the requirement that an ERISA plan administrator provide covered participants and certain beneficiaries with an annual, narrative statement –called a summary annual report (SAR) – summarizing the material information contained in the plan's Form 5500. A SAR is subject to certain content, notification and distribution rules under ERISA, and plan administrators may be liable for non-compliance to such rules.

Generally, if a plan is required to file a Form 5500, that plan's administrator is also required to distribute a SAR to each plan participant and beneficiary. The SAR must be provided within nine months of the close of the plan year (or within two months after the close of any applicable extension period).

The SAR must contain a summary of the plan's most recent Form 5500. While an exact determination of a SAR's contents would be based on a particular plan's most recent Form 5500, there are some general categories of content that will likely be included in a SAR, including: (1) funding and insurance information, (2) basic financial information (i.e., plan income and losses, investment earnings) and (3) participants' rights to additional information.

As with a summary plan description, generally, the SAR must be distributed in a manner that is reasonably calculated to ensure actual receipt by plan participants. For all participants, the SAR may be sent by mail, hand-delivered or inserted in a company publication. It is not sufficient to post the SAR on the internet, intranet or bulletin board unless a separate notification informs participants of the location of the SAR, the significance of the document and a statement as to the right to request a paper version. For certain participants, the SAR may be sent electronically.

Although no specific penalty applies to a plan's failure to distribute a SAR, participants and beneficiaries may bring suit to enforce any provision of ERISA. Also, criminal penalties of up to 10 years in prison and \$100,000 fine may be imposed for willful violations of any ERISA disclosure requirement.

Employers should consult their advisors to determine best practices with respect to SARs, including the specific content, notification and distribution rules discussed above.

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