IRS Letter Allows Employees to Allocate Discretionary Employer Contributions Among Various Benefits

EBIA Weekly (September 5, 2024)

Priv. Ltr. Rul. 202434006 (May 20, 2024)

Available at ***https://www.irs.gov/pub/irs-wd/202434006.pdf***

An IRS private letter ruling has concluded that an employer may allow employees to allocate non-elective, discretionary employer contributions among a 401(k) plan, retiree health reimbursement arrangement (HRA), health savings account (HSA), or Code § 127 educational assistance program (EA Program) without jeopardizing the beneficial tax consequences of these programs. Specifically, the employer proposed reducing its discretionary 401(k) plan contribution and allowing eligible employees to make annual irrevocable elections during open enrollment to allocate an additional employer contribution among the 401(k) plan, the retiree HRA (for employees age 55 or older with ten years of service), the EA Program (solely for employer payments of principal or interest on qualified education loans), and an employee's HSA. (If no election was made, the employer contribution would be allocated to the 401(k) plan.) Employees would not be permitted to receive cash or a taxable benefit. As proposed, the employer contribution would be allocated on or about March 15 of the following year and would be treated as a contribution or benefit payment in the year of contribution, except that retiree HRA contributions would be treated as notional contributions made on December 31 of the year of the employee's election (the date used to credit interest under the retiree HRA). Employees choosing the EA Program or their HSA would be ineligible for other 127 plan benefits or pre-tax HSA contributions until after the March 15 contribution date to avoid exceeding applicable benefit limits.

The letter first concluded that the proposal would not create an additional cash or deferred arrangement under Code § 401(k), because it did not permit employees to elect between having the employer contribution paid in cash (or another taxable benefit) or contributing it to a deferred compensation plan. Therefore, the employer contribution was not an employee pre-tax contribution subject to the annual elective deferral limitation. Next, the letter concluded that the amended retiree HRA would still meet applicable HRA requirements, and coverage and benefits under the retiree HRA would remain excludable from gross income. This was because (1) employees were not permitted to elect to have employer contributions paid in cash (or another taxable benefit), (2) employer contributions were not made pursuant to salary reduction elections, (3) contributions would only be used to provide benefits that reimburse Code § 213(d) medical expenses (and could not be used to provide other taxable or nontaxable benefits), and (4) unused amounts would be carried forward to subsequent periods after the employee's retirement.

The letter also concluded that employees' allocations of employer contributions to their HSAs would be excludable from their gross income if employer contributions did not exceed statutory limitations and only HSA-eligible employees could elect to allocate employer contributions to their HSAs. In addition, because

© 2024 Thomson Reuters/EBIA. All rights reserved.

employees had no choice between educational assistance and other remuneration includible in their income, the proposal would not affect the treatment of payments from the EA Program as amounts excludable from gross income, subject to the Code's statutory limit. Furthermore, employees' ability to allocate the employer contributions among different programs would not disqualify the EA Program under the Code.

EBIA Comment: Private letter rulings are intended only for the parties that request them and cannot be used or cited as precedent. However, they often provide insight into the IRS's thinking. This letter may be helpful to employers that have or are considering benefit arrangements that allow employees to choose among benefits they want funded. One key requirement seems to be that employees cannot choose to receive amounts in cash or taxable benefits. For more information, see EBIA's 401(k) Plans manual at Section VIII.B ("Cash or Deferred Arrangement (CODA)") and EBIA's Fringe Benefits manual at Section X ("Qualified Educational Assistance Programs"). See also EBIA's Consumer-Driven Health Care manual at Sections IX ("HSAs: Who is Eligible?"), XII.I ("Employer HSA Contributions"), XXI.B ("HRA Legal Requirements"), and XXII.D ("HRAs Must Be Funded Exclusively by Employer and Not With Salary Reductions or Otherwise Under a Cafeteria Plan").

Contributing Editors: EBIA Staff.

© 2024 Thomson Reuters/EBIA. All rights reserved.