

insights

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Benefit issues impacting older workers

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Men and women in the United States are delaying retirement or re-entering the workforce after normal retirement age in increasing numbers. According to [a Pew Research Center report](#), the number of Americans over age 65 who are employed rose from 12.8 percent in May 2000 to 18.8 percent in May 2016. The Pew Research Center report also notes that older workers are working longer hours. In May 2000, 46.1 percent of workers age 65 and older were working part-time (less than 35 hours a week as defined by the Bureau of Labor Statistics). By May 2016, only 36.1 percent of workers age 65 and older were working part-time.

There are a number of factors that may be driving this trend, including improved life expectancies and quality of life, the increase in the Social Security normal retirement age, the elimination of employer-provided retiree medical benefits, and uncertainty regarding the solvency of government retirement programs, such as Social Security and Medicare.

Regardless of the reason, the increased presence of older Americans in the workforce has created a number of interesting benefit issues for employers with respect to retirement and medical plans.

Defined Benefit Plans

Separation from service

Qualified defined benefit plans, commonly known as pension plans, typically require a separation from service on or after retirement age (normal or early) for benefits to commence. Issues often arise with respect to older workers who want to both start their pension benefits and continue working. An example is an employee whose current plan benefit is not sufficient to support the employee and spouse. The employee may ask his employer to “retire” with the understanding that the employee will resume part-time employment after a specified period of absence.

Such a fact pattern may put the defined benefit plan at risk of disqualification by the Internal Revenue Service. Even if the employee is processed as a retiree on the employer’s payroll system and coded as a new employee upon his scheduled return, in the event of a plan audit, the IRS may take the position that no separation from service has occurred and that the plan administrator has failed to follow the terms of a plan. Although such a failure is grounds for disqualification of the plan, the IRS will typically impose penalties in lieu of such drastic action. If there is such a prearranged plan for the employee to return to employment after “retirement,” it does not matter whether the gap period is one day or six months.

If a retired employee returns to employment without prearrangement between the employee and employer, there is no issue. For example, if a retiree is brought back to work after the replacement unexpectedly resigns, there is no qualification issue. However, in such a case, it is advisable to document the facts and circumstances with respect to the rehired employee, in case the termination is questioned by the IRS in an audit.

In-service distributions

To avoid the separation from service issue, some defined benefit plans have been amended to include a provision permitting the distribution of plan benefits while an older employee is still working. Such distributions are commonly referred to as “in-service distributions.”

The Pension Protection Act of 2006 revised the Internal Revenue Code to permit in-service distributions at age 62. However, before adopting such a provision, a plan sponsor must weigh the possible adverse impact on the workforce.

For example, such a provision could create an incentive for an older worker to start benefits early, creating the possibility that the worker will have insufficient income for support throughout the retirement years. Such a

provision could also encourage an older worker to switch from a full-time schedule to part-time work, allowing the participant to supplement retirement benefits with part-time earnings.

The result could wreak havoc on an employer's workforce.

Suspension of benefits

Another possible issue with rehiring older employees involves the suspension of benefits. ERISA permits, but does not require, a defined benefit plan to suspend the payment of retirement benefits if a retiree continues to work beyond normal retirement age or is rehired after a bona fide retirement. If a defined benefit plan includes a suspension of benefits provision and benefits are suspended, the participant is not entitled to any adjustment of the retirement benefit for the "missed" benefit payments during the period of reemployment (or continued employment beyond normal retirement age). However, ERISA prohibits a suspension of benefits if a participant works fewer than 40 hours per month. ERISA also requires that a notice be provided to a participant prior to the suspension of benefits.

Recalculation of accrued benefits

When a retiree is rehired, the plan administrator must consider the impact on the participant's accrued benefit. Most defined benefit plans require 1,000 hours of service during a plan year for the accrual of benefits for such plan year. If a rehired employee works more than 1,000 hours during the plan year, additional actuarial services will be required to recalculate the employee's benefits when the employee again retires. It will be important to review the provisions of the plan so that benefits are accurately calculated for rehired employees. In some cases, it may be possible for the plan sponsor to regulate a participant's hours to avoid this issue.

Defined Contribution Plans

Fewer issues arise if an employer maintains a defined contribution plan, such as a 401(k) plan, and an older worker continues employment beyond normal retirement age or is reemployed by the employer.

Separation from service

Section 401(k)(2)(B) of the Internal Revenue Code provides that salary deferral contributions under a 401(k) plan can only be distributed to a participant upon death, disability, hardship, separation from service or attainment of age 59½. Thus, as with defined benefit plans, an issue arises if an older worker terminates and is immediately rehired or rehired within a prearranged period. The IRS may argue that no separation from service has occurred and that distributions have been improperly made from the 401(k) plan, risking disqualification of the plan.

Medical Plans

Medicare penalty

Generally, a Medicare penalty applies if an individual does not apply for Medicare coverage at age 65. However, the Medicare penalty will not apply if an individual fails to apply for Medicare because he is covered under his employer's medical plan. Similarly, the Medicare penalty will not apply if an individual fails to apply for Medicare because the individual is covered under the spouse's medical plan. These exceptions apply only if an individual is covered under an employer's medical plan due to the active employment of the individual or the spouse.

Thus, these exceptions do not apply if an individual fails to apply for Medicare because the individual is covered under a retiree medical plan maintained by a former employer.

Medicare secondary payer rules

The impact of the Medicare Secondary Payer Rules on older employees depends on the size of the employer.

Generally, the Medicare secondary payer rules prohibit an employer from reducing health benefits offered to current employees due to their eligibility for Medicare based on age. Provided the employer has 20 or more employees, the employer medical plan is the primary payer and Medicare is the secondary payer. However, if the employer has fewer than 20 employees, Medicare will be the primary payer and the employer medical plan is the secondary payer with respect medical claims made by Medicare-eligible employees.

Medicare and retiree medical plans

The Medicare Secondary Payer Rules only apply to medical plan coverage for active employees. Thus, in the case of employer-provided retiree medical plans, Medicare is the primary payer for Medicare-eligible retirees and the employer's retiree medical plan is secondary. Given this fact, there are several ways that retiree medical plans can coordinate with Medicare.

For example, a retiree medical plan can be designed as a bridge plan that provides medical coverage from the time an employee retires until the employee becomes eligible for Medicare.

Alternatively, a retiree medical plan can be designed as a supplemental plan that provide retirees with coverage for out-of-pocket expenses not otherwise covered by Medicare, including the cost of co-insurance and deductibles.

Medicare and COBRA

The Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), requires continued medical plan coverage for a specified period after an employee terminates employment. The period of COBRA

coverage can be shortened due to certain events such as becoming entitled to Medicare depending on when the terminated employee first became entitled to Medicare. If an employee first becomes entitled to Medicare before termination of employment, then Medicare coverage will not shorten the period of COBRA coverage. However, if the employee first becomes entitled to Medicare after termination of employment, COBRA coverage will cease as of the effective date of Medicare coverage. For this purpose, Medicare "entitlement" is defined as eligibility plus Medicare enrollment.

Medicare and health savings accounts

If an employee participates in a high-deductible medical plan with a health savings account (HSA), neither the employee nor the employer is permitted to make additional contributions to the HSA after the employee begins any type of Medicare coverage. Once an employee begins to receive Social Security retirement benefits, he will automatically be enrolled in Medicare Part A coverage at age 65. Thus, if an employee wants to continue to contribute to an HSA, he must forego Social Security benefits.

Age Discrimination in Employment Act

The Age Discrimination in Employment Act (ADEA) provides that an employer may not deny the opportunity to participate in benefit plans because of age. Under ADEA, an employer may not reduce a benefit due to age unless the cost of the benefit increases with age. An example is life insurance. An employer will not violate ADEA if it spends the same per-employee amount on life insurance for older and younger workers even though the level of life insurance coverage provided to older employees is lower.

The list of issues is not intended to be exhaustive. However, it does reflect some of the additional considerations that an employer may encounter in designing benefits for older workers.

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authorsTest

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Lori

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