What Employers Need To Know About H-2A Workers & 401(k) Plans

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Agenda

• H-2A Worker Status as Employees
• Common Problems Created by Employee Status
• Strategies to manage H-2A worker participation
• How you fix it when it's broken
Discussions here:

- Not confidential or privileged
- Not “legal advice” – hypotheticals only
- Only a very basic overview of the law – essential to obtain legal advice before acting – we cannot provide tax advice outside of attorney-client relationship
- But like website materials, we hope the information and documents will point you in the right direction
H-2A Program Compliance With Federal & State Laws

• H-2A program rules require compliance with all applicable Federal and State laws and regulations
  • Employee Retirement Income Security Act (ERISA)
  • Internal Revenue Code (IRC)
  • Title VII of the Civil Rights Act (Title VII)
  • Immigration Reform and Control Act (IRCA)

• In particular, IRCA prohibits discrimination based on citizenship status with respect to hiring, discharge, recruitment, or referral for a fee
  • Though, there are some specific circumstances in which employers are permitted to prefer hiring a U.S. citizen over an alien
H-2A Program Compliance With Federal & State Laws

• IRCA and many state employment laws prohibit discrimination based on citizenship status with respect to all aspects of employment – including benefits.
  • This means you can’t exclude “H-2A Employees” from your employee benefit plans based solely on that status

• IRS views H-2A workers as “employees”
  • ACA Employer Shared Responsibility Regulations specifically decline to exclude H-2A workers from definition of employee for group health plan coverage requirements
  • No exceptions in IRC or ERISA relating to benefits provisions that exempt H-2A workers from requirements applicable to all employees
Impact on Benefit Plans and Programs

• ERISA protects rights to benefits – bound by terms of plan and can be on hook for benefits promised (even retroactively)

• Types of Plans at Issue Under ERISA
  • Medical/Dental/Vision/Rx/EAP
  • Group-Term Life Insurance/AD&D
  • STD and LTD, etc
  • Retirement Plans, including 401(k)
Impact on Benefit Plans and Programs

• Check your Plan Definitions – *how is employee defined? Most likely no exclusion for H-2A – can’t assume not covered*

• Creates a Cause of Action under ERISA to enforce benefits rights (*Microsoft Case*)

  • Seasonal workers excluded from count of 50 if work less than 4 months
  • Can exclude seasonal employees who are anticipated to work less than 6 months – but not longer
  • May not be useful for H-2A who can work up to 10 months
401(k) Plans

• Must satisfy rigorous tax requirements in order to “qualify” for the tax benefits offered under Code §401(a):
  • Eligibility
  • Contributions
  • Distributions
  • Vesting
  • Nondiscrimination
401(k) Plans

• ERISA requires satisfaction of duplicate and additional requirements as the IRC:
  • Eligibility
  • Vesting
  • Fiduciary Rules
  • Plan Administration
  • Reporting and Disclosure
Types of 401(k) Plans

• **Traditional 401(k) plans**
  - Employees can contribute pre-tax, Roth or after-tax
  - Employer can choose whether they want to contribute
    - Can contribute for all participants (even if they don’t contribute), make matching contributions based on an employee’s elective deferral, or both
  - Employer contributions do not have to be fully vested when made (can be subject to a vesting schedule)
  - Must perform annual non-discrimination testing as to coverage for each contribution type and for the amount of contributions
Types of 401(k) Plans

• Safe harbor 401(k) plans
  • Employer must contribute
    • Match 100% of the first 3% of employees’ compensation they elect to contribute, and match an additional 50% for each contribution that is over 3% but under 5% (or 100% of compensation up to 4%); or
    • Contribute 3% of eligible employees’ compensation, regardless of whether they contribute
  • Employer contributions must be fully vested when made
  • Not required to perform annual non-discrimination testing as to contributions – still have coverage testing for each contribution type
Types of 401(k) Plans

• **SIMPLE 401(k) plans**
  • Only available if you have 100 or fewer employees
  • Employer must contribute
    • Match up to 3% of employees’ compensation if they elect to contribute
    • Contribute 2% of eligible employees’ compensation, regardless of whether they contribute
  • Employer contributions must be fully vested when made
  • Not required to perform annual non-discrimination testing
401(k) Plans

WHICH EMPLOYEES MUST BE INCLUDED IN YOUR PLAN?
• Rule does not require coverage of all employees and plan may impose eligibility conditions unrelated to age or service (e.g. union or non-union).

• BUT! IRS rules prohibit exclusions for categories that are “disguised” age or service rules –
  • possible that H-2A exclusion permissible under IRS 410(a) – but IRCA to consider – both apply and facts and circumstances determination
401(k) Plan Minimum Age and Service Requirements - §410(a)

Common Plan Exclusions that are permissible:

• Independent Contractors (classified by employer)
• Leased Employees
• Collectively-Bargained Employees whose bargaining agreement doesn’t provide for participation
• Job Classifications that are not disguised age or service
• **Non-resident aliens with no U.S. Source Income** (some H-2A workers could benefit from this exclusion if U.S. has a treaty with country of origin, but rare – this category of exclusion is not only permissible, employees within this category are not counted in the discrimination and coverage tests)
401(k) Plan Minimum Age and Service Requirements - §410(a)

• Those in eligible classification may not be excluded beyond the later of:
  • the date on which the employee attains age 21; or
  • the date on which the employee completes one “year of service” (1,000 hours or elapsed time (12 month period from date of hire – no hours) OR if plan provides for immediate vesting two “years of service”

• May disregard periods in which employee has a “break in service” - a break in service generally is an eligibility computation period (12 months) during which the
  • employee is credited with 500 or fewer hours of service. A termination of employment is not necessary to incur a break in service
  • H-2As who are rehired year after year likely will not have a break in service even though employment period not continuous
401(k) Plan Entry Date Requirements §410(a)(4)

• Once meet age and service for eligibility, must allow employee to participate (make or receive contributions) under the plan no later than the earlier of:
  • the first day of the first plan year beginning after the date on which the employee satisfied the minimum age and service requirements; or
  • the date 6 months after the date on which the employee satisfied the minimum age and service requirements.
401(k) Plans – Non-Discrimination in Coverage (§410(b))

• What Is the Purpose?
  • The purpose of the test is to make sure a plan that excludes certain employees by job category or status covers enough NHCEs. Also applies to each contribution type under the plan (deferrals, Roth, matching, NEC)

• Who is an HCE?
  • For 2019 PY, an employee who earns more than $120,000 in 2018 PY

• How Much Is “Enough”?
  • Cover 70% of all NHCEs or satisfy Ratio Percentage (Numerical) or Average Benefits Test (More Subjective)

• How do H-2A Employees Fit In
  • H-2A Employees must be included in the testing as benefiting or non-benefiting – this will impact testing results. But, we are assuming for presentation today that can’t exclude under IRCA.
Recap of Coverage/Eligibility Issues

• H-2A workers are probably not excluded under your current 401(k) plan terms
  • Need to look at your plan’s eligibility provisions. All plans start with coverage for “common law” employees at a minimum and then apply exclusions

• Employers generally cannot exclude H-2A workers from their plan
  • IRCA and employment laws prohibit discrimination in pay and other benefits based on citizenship/immigration status

• Employers may assume H-2A workers exempt or not interested and not offer participation

• Failure to allow eligible employees to participate in the plan violates ERISA and the IRC
Consequences of ERISA/IRC Violations

• IRC Violation – plan could be “disqualified” – worst case scenario – plan loses tax-exempt status
  • Employees required to include contributions in their gross income
  • Employer deductions for plan contributions are limited
  • Plan trust owes income taxes on trust earnings
  • Rollovers are disallowed
  • Contributions are subject to Social Security, Medicare and Federal Unemployment Taxes

• IRS Correction Programs allow employers to “fix” – but expensive (discussed later)

• ERISA Violation – DOL enforce terms of plan – retroactive coverage and benefits
IMPACT OF INCLUDING H-2A EMPLOYEES

(You’ve got them covered, but just what does that mean to your plan?)
401(k) Plans

I. SIZE MATTERS
Size Matters

• SIMPLE 401(k) plans
  • Only available if you have 100 or fewer employees – were H-2A employees considered?
  • Could be an ineligible sponsor
Size Matters

• Trigger additional Form 5500 Requirements
  • Plans with < 100 participants have simplified reporting requirements (Form 5500-SF)

• Plans with 100 or more participants as of the beginning of the plan year must include an audit of the plan’s records with its annual Form 5500 filing (Schedule H)
  • The audit must be conducted by an independent qualified public accountant, which can be expensive
  • Limited exception for employers that fluctuate between 80 and 120 employees from year-to-year
II. PARTICIPATION MATTERS
Participation Matters

- **Traditional 401(k) plans** - must perform annual non-discrimination testing for each contribution type and for the amount of contributions.

- 401(k) and Roth: Average ADP for HCEs may not be greater than:
  - 1.25 x average ADP of NHCEs or
  - Lesser of: 2 x average ADP for NHCEs or 2% more than average ADP for NHCEs

- After-tax and Match: Same basic test and alternative test as ADP test

- Assume H-2A workers not interested in deferring, which will bring down NHCE ADP and ACP:
  - If fail – must return contributions to HCEs (forfeit match) or contribute additional funds to NHCEs until tests are satisfied.
Participation Matters

• **Traditional 401(k) plans** - must perform annual non-discrimination testing for each contribution type and for the amount of contributions

• Profit Sharing Contributions (Non-elective contributions)
  • Must satisfy general non-discrimination rules and 410(b) coverage requirements (ensures contribution available to sufficient percentage of NHCEs)
  • Generally available to all employees eligible to participate – any conditions would have to satisfy minimum age and service requirements as well as general non-discrimination requirements
Participation Matters

- **Safe harbor 401(k) plans**
  - Employer must contribute
    - Match 100% of the first 3% of employees’ compensation they elect to contribute, and match an additional 50% for each contribution that is over 3% but under 5% (or 100% of compensation up to 4%); or
    - Contribute 3% of eligible employees’ compensation, regardless of whether they contribute
  - Employer contributions must be fully vested when made
  - Not required to perform annual non-discrimination testing as to safe harbor contributions – still have coverage testing for each contribution type
401(k) Plans

STRATEGIES TO DISCUSS WITH LEGAL COUNSEL AND TPA
Strategies to Manage H-2A Worker Participation

• Traditional Plan - Vesting
  • Can impose graduated vesting or cliff vesting for employer contributions (but employee contributions are always 100% vested)
  • However, under safe harbor plan, employer contributions must be fully vested when made
Strategies to Manage H-2A Worker Participation

• Safe Harbor Plan - Matching vs. Non-Elective
  • Employer must contribute
    • Match 100% of the first 3% of employees’ compensation they elect to contribute, and match an additional 50% for each contribution that is over 3% but under 5% (or 100% of compensation up to 4%); or
    • Contribute 3% of eligible employees’ compensation, regardless of whether they contribute (no last day rule)

• Auto-Enrollment – Safe Harbor designs available – although increases likelihood of passing testing in Traditional plans or exempt from testing in certain safe harbor plans, it increases H-2A account balances – practical issues may outweigh benefits here

• Last Day Rule (Match or NEC) Traditional Plans – be careful of subterfuge for discrimination issues (IRC and IRCA)
CORRECTING THE PROBLEM YOU MAY ALREADY HAVE
How do you fix it?

• The Internal Revenue Service (IRS) has specific procedures for correcting plan errors called the Employee Plans Compliance Resolution System (EPCRS)

• Under EPCRS, employers can file an application under the IRS’s Voluntarily Correction Program (VCP) to avoid plan disqualification – minor or recently discovered errors may be self-corrected.

• There is also a filing fee between $1,500 & $3,500 depending on the plan’s assets

• If H-2A workers are eligible under your plan’s terms, but they have not been allowed to participate:
  • Retroactively make up contributions for all improperly excluded employees (with earnings) (must contribute 50% of missed deferral opportunity and 100% of match and NEC)
Takeaway Points

• There are a lot of rules governing H-2A workers
• There are a lot of rules governing 401(k) plans
• Review and follow your plan’s eligibility provisions

• If you are not compliant, consider correcting
• Discuss with legal counsel the strategies to limit eligibility and manage participation