

# Employee Benefits Corner

*By Elizabeth Thomas Dold and David N. Levine*

## Military Relief Under the HEART Act—Year-End Plan Amendments Needed

President Bush signed the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) on June 17, 2008. The Act, in part, provides certain tax benefits and pension and welfare incentives to military personnel. This law was the first since the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) to provide comprehensive relief for military personnel. USERRA provides that employees who leave a civilian job for qualified military service are entitled to be reemployed with the same employer, provided certain eligibility provisions are satisfied and also provides for entitlement to certain pension, profit-sharing and similar benefits that would have been received but for the employee's absence during military service. For example, an employee reemployed under USERRA is treated as not having a break in service because of the military service; the employee's military service is treated as service for vesting and benefit accrual purposes; the employee is permitted to make make-up contributions (either 401(k) contributions or after-tax contributions) upon return for the missed period; and the employee is entitled to receive related accrued benefits that are contingent on such contributions (e.g., matching contributions).

Under the HEART Act, additional relief provisions are provided for military personnel, and Notice 2010-15 provides much-needed guidance on the proper interpretations of the key pension provisions, in question-and-answer format. Importantly, it clarified that plan amendments are needed by the end of the 2010 Plan Year (2012 Plan Year for governmental plans), but no sample amendments are included in the guidance. The pension relief and the related clarifications are summarized below.



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## **I. Section 104 of the HEART Act—Mandatory Death Benefits**

Section 104(a) of the HEART Act adds Code Sec. 401(a)(37) to the Internal Revenue Code of 1986, as amended (“the Code”). This provision requires qualified retirement plans (401(a)—all profit sharing and pension plans, 403(b) annuities and governmental 457(b) plans) to provide a beneficiary of the participant who dies while performing “qualified military service” to any additional benefits (other than benefit accruals related to the period of qualified military service) that would have been provided under the plan had the participant resumed employment and then terminated employment on account of death. This provision applies retroactive to deaths occurring on or after January 1, 2007.

Notice 2010-15 provides the following helpful clarifications:

- **Eligibility.** This provision only applies to participants who would have been entitled to reemployment rights under USERRA if he or she had applied for such rights immediately before his or her death.
- **Types of Benefits Impacted.** Any benefits under the Plan that would otherwise be provided to such participant if he had died while employed (other than benefit accruals for such period) should apply, including (if the plan includes such provision) (1) accelerated vesting on death while an employee, (2) ancillary life insurance benefits under the plan for a participant who dies while employed, (3) other survivors’ benefits provided under the plan that are contingent on a participant’s termination of employment on account of death.
- **Amount of Death Benefit.** This provision does not impact the amount of the benefits paid. Specifically, this provision does not require that benefit accruals, whether under a defined benefit plan (e.g., traditional or cash balance plan) or contributions under a defined contribution plan (e.g., profit-sharing plan, money purchase plan, 401(k) plan), be imputed for the period of qualified military service for purposes of determining death benefits that are based on a deceased participant’s accrued benefit.
- **Vesting of Death Benefit.** This provision requires that with respect to these death benefits, the vested amount is determined by counting

the period of qualified military service performed by the participant as vesting service under the plan.

While many plans do not provide for such additional death benefits (which are more typical in multiemployer plans and governmental plans), we recommend that all qualified retirement plans be amended by the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans), to provide for this relief. The Notice fails to provide sample amendment language, but absent additional guidance, the following paragraph may be sufficient to serve as a good-faith amendment:

Effective January 1, 2007, the beneficiary of a Participant on a leave of absence to perform military service with reemployment rights described in Code Section 414(u) where the Participant cannot return to employment on account of his or her death, shall be entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) that would be provided under the Plan had the Participant died as an active Employee, in accordance with Code Section 401(a)(37).

## **II. Section 104(b) of the HEART Act—Optional Benefit Accruals**

Section 104(b) of the HEART Act adds new Code Sec. 414(u)(9). This provision permits, but does not require, for benefit accrual purposes, an employer sponsoring a retirement plan may treat a participant who dies or becomes disabled while performing qualified military service as if he or she resumed employment in accordance with his or her USERRA reemployment rights on the day preceding the death or disability and then terminated employment on the actual date of death or disability. This provision, if elected, must apply on reasonably equivalent terms for similarly situated participants—a nondiscrimination requirement. For 401(k) plans, the amount of after-tax employee contributions and 401(k) deferrals (including Roth deferrals) that are deemed contributed (in order to determine the proper employer contribution) are determined based on the participant’s average actual employee contributions or 401(k) contributions for the lesser of (1) the 12-month period of service with the employer immediately prior to

qualified military service, or (2) the actual length of continuous service with the employer. This provision applies retroactive to deaths or disabilities occurring on or after January 1, 2007.

Notice 2010-15 provides the following helpful clarifications:

- **Effective Date.** The provision can be applied to deaths and disabilities as of any date on or after January 1, 2007. Presumably, this provision can be extended to death, disabilities, or both. However, the nondiscrimination rules regarding the timing of plan amendments under Reg. §1.401(a)(4)-5 will apply, which is intended to prevent the timing of the amendment to favor highly compensated employees (HCE).
- **Vesting of Optional Benefit Accruals.** For this purpose, vesting service must be provided for the period of qualified military service performed by the participant prior to death; however, in the event of disability, vesting service under the plan is not required to include the period of qualified military service performed by the participant prior to becoming disabled. If the employer wants to count such service for the disability accruals, it is permissible provided that it complies with the imputed service rules under the Code (see Reg. §1.401(a)(4)-11(d)(3)), which are deemed satisfied if the plan provision crediting the service to any HCE applies on the same terms to all similarly situated non-HCEs.
- **Defined Contribution Plan Accruals.** A participant who dies or becomes disabled while performing qualified military service is deemed to have made employee contributions or elective deferrals for the purpose of determining accrual accruals that are contingent on such contributions. For this purpose, the participant is deemed to have made employee contributions or elective deferrals in an amount equal to the lesser of the actual average employee contributions or elective deferrals made by the participant under the plan during the 12-month period prior to military service, or, if less than 12 months, the period of continuous service with the employer. However, if the disabled participant was entitled under the Plan to make-up the missed employee contributions/elective deferrals under USERRA, the plan can use those actual deferrals to determine the HEART Act accrued benefits.
- **Amendment Deadline.** If a plan sponsor elects to offer this provision prior to January 1, 2010, it should be reflected in a plan amendment by the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans). Presumably, if added thereafter, the general interim amendment provision will apply—the tax filing deadline (plus extensions) for the year it became effective. Accordingly, if the plan sponsor elects to offer this provision, the plan document will need to be amended to reflect the approach taken, including designating (1) the effective date, (2) whether it extends to death and disability, (3) whether imputed service for vesting purposes will be credited for disabled participants, and (4) how the accruals are determined (particularly for defined contribution plans that have the option for disabled participants to contribute make-up USERRA contributions).

### III. Section 105 of the HEART Act—Differential Wage Payments and Deemed Severance from Employment

Section 105(a) of the HEART Act amends Code Sec. 3401 to treat “differential wage payments” as wages for income tax withholding purposes (but not wages for FICA or FUTA taxes). Differential wage payments is defined as any payment that (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services while on active duty for a period of more than 30 days, and (2) represents all or a portion of the wages the individual would have received from the employer if the individual were performing services for the employer. This provision applies to remuneration paid after December 31, 2008. (Note that the HEART Act also added a tax credit to eligible small business employers that make differential wage payments, which is also described in the Notice.)

Section 105(b) of the HEART Act adds Code Sec. 414(u)(12)(A), which provides that for retirement plan purposes, (1) a participant receiving differential wage payment is treated as an employee of the employer making the payment, (2) the differential wage payment is treated as compensation, and

(3) the plan is not treated as failing to meet the requirements of any provisions described in Code Sec. 414(u)(1)(C) (which is the various nondiscrimination requirements, including 401(a)(4), 401(k)(3) and 401(m)) by reason of any contribution or benefit which is based on the differential wage payment. (Note: For determining the limitation on contributions to IRAs, the term compensation similarly includes differential wage payments.) This provision applies to years beginning after December 31, 2008.

Section 105(b) of the HEART Act also adds Code Sec. 414(u)(12)(B), which provides that an individual is treated for purposes of plan distributions (including distributions from a designated Roth account under Code Sec. 402A) under 401(k), 403(b)(7), 403(b)(11) and 457(b) (*i.e.*, elective deferrals under 401(k), 403(b) plans and custodial 403(b) accounts, and 457(b) plans) as having been severed from employment during any period the individual is performing service in the uniformed services described in Code Sec. 3401(h). For this purpose, if the participant elects to receive such a distribution, the plan must provide that the participant may not make an elective deferral or employee contribution during the six-month period beginning on the date of the distribution. This provision also applies to years beginning after December 31, 2008.

Notice 2010-15 provides the following helpful clarifications:

■ **Differential Wage Payments Treated as Compensation.** Importantly, differential wage payments are not required to be treated as compensation for purposes of determining contributions and benefits under a plan. However, such payments must be treated as compensation for purposes of applying the Code—which means that they must be counted for 415 compensation purposes. Importantly, the Notice clarifies that the definition of compensation will not fail to satisfy Code Sec. 414(s) if differential payments are excluded. Presumably, this means that for nondiscrimination testing purposes (*e.g.*, ADP, ACP), differential wage payments may be excluded. In the event the Plan treats differential wage payments as compensation for contributions and benefits under the plan, such contributions or benefits can be excluded from the plan's nondiscrimination testing, provided that the provision is applied

on reasonably equivalent terms. Conversely, these amounts can be taken into account for discrimination testing (if taken into account for all employees), provided that it does not cause the plan to fail such tests.

■ **Deemed Severance from Employment Distribution.** This distribution provision is entirely optional; the plan sponsor does not have to provide for it in the plan. However, if it is offered, the six-month suspension period must apply. Moreover, the six-month suspension provision for a distribution of elective deferrals under a 401(k), 403(b) or 457(b) plan applies regardless of whether or not the participant is receiving differential wage payments. Also, this provision does not impact any other Code provisions (*e.g.*, the distribution would remain eligible for rollover) and does not apply if the participant has an actual severance from employment or is not otherwise eligible to take a distribution. Lastly, in the event that the plan offers this provision and the optional PPA provision for qualified reservist distributions (under Code Sec. 72(t)(2)(G)(iii)), and the participant is eligible for both, the distribution must be treated as a qualified reservist distribution.

Accordingly, depending on what is offered to plan participants, the Plan document will need to be amended to reflect the approach taken. For example, the definition of compensation for plan and testing purposes should be reviewed to ensure it reflects the plan's approach (and be careful not to trigger anti-cutback provisions as no cutback relief was provided in the Notice). At a minimum, the definition of 415 compensation should be amended to include differential wage payments under Code Sec. 3401(h).

## **IV. Section 107 of the HEART Act—PPA's Qualified Reservist Distribution**

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Section 107 of the HEART Act amends Code Sec. 72(t)(2)(G) that was added under the Pension Protection Act of 2006 (PPA) to provide for in-service distribution of elective deferrals under 401(k) or 403(b) plans for qualified reservist distributions. This provision was set to expire as of December 31, 2007, and the HEART Act eliminate the ex-

piration date altogether. This provision no longer has an expiration date, and applies to participants ordered or called to active duty on or after December 31, 2007.

Notice 2010-15 provides that if a plan sponsor elects to offer this provision, it should be reflected

in a plan amendment by the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans). However, if the PPA provision was added without an express reference to the December 31, 2007, deadline, presumably no amendment would be necessary.

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