

Synopsis of the Soldiers' and Sailors' Civil Relief Act

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Recent events have led many employers to inquire how federal statutes such as the Uniformed Services Employment and Reemployment Act of 1994 ("USERRA"), (38 U.S.C. §§ 4301-4333) impact their obligations with respect to benefits for employees who enter military service. While USERRA has appropriately begun to receive much attention, there is another statute that employers should also be aware of because of its potential impact on the administration of plan loans- The Soldiers' and Sailors' Civil Relief Act of 1940 ("SSCRA"), (50 U.S.C. App. §§ 501-593). Section 526 of the SSCRA limits the interest that may be charged on outstanding obligations and liabilities of persons who enter active duty military service. The Pension and Welfare Benefits Administration (PWBA) of the Department of Labor recently added a statement to the "Frequently Asked Questions and Answers" section of their website confirming that the SSCRA interest limitation applies to plan loans and indicating that a loan will not fail to be a qualified loan under ERISA solely because the interest rate is capped by SSCRA. This position appears to be consistent with both the SSCRA provision, which is broadly worded, and with Title I of ERISA, which specifically provides that ERISA does not supercede any federal law. This article gives a brief synopsis of the SSCRA maximum rate of interest provision, provides a brief review of USERRA as it applies to plan loans, and finally, notes outstanding issues that employers should be aware of when administering plan loans in accordance with the SSCRA and USERRA.

The Soldiers' and Sailors' Civil Relief Act of 1940 ("SSCRA"). The SSCRA provides protection for individuals entering or called to active duty in the military service. The Act contains several specific provisions designed to protect the civil rights of active duty military personnel, including section 526, which imposes a 6 percent limitation upon the interest rates that can be charged to a service member for obligations or liabilities incurred before active duty began. "Interest" under this provision includes service charges, renewal charges, fees, or any other charges associated with the obligation or liability.

The 6 percent limitation does not apply in cases where a creditor can prove that the military service member's ability to pay interest in excess of 6 percent per year is not "materially affected" because of military service. Such a challenge would seem likely to be successful in cases where there is clear evidence that the military service did not put the service member at a financial disadvantage, such as where an employer supplements a reservist's salary when that person goes on active duty to compensate for the military pay differential.

Application of SSCRA to Plan Loans. Although there is no authority directly on point, the language of the statute broadly states, without exception, that the interest rate limitation applies to an "obligation or liability." Since a plan loan is clearly an obligation or liability, it satisfies the plain language of the statute. Further, with respect to Title I of ERISA, the preemption provision under section 514(d) provides that nothing in ERISA shall be construed to "alter, amend, modify invalidate, impair, or supersede any law of the United States" or "any rule or regulation issued under any such law." This means that if a plan loan is an "obligation or liability" within the

meaning of SSCRA § 526, the rules and regulations that normally govern plan loans under Title I of ERISA must not be interpreted in a manner that would preclude the application of SSCRA.

Although the statute itself contains no restrictions on the definition of "obligation or liability", certain military pronouncements designed to advise service members of their rights under SSCRA have stated that SSCRA § 526 is not intended to apply to non-commercial obligations or liabilities.¹ However, this does not appear to offer a basis for arguing that the SSCRA does not apply to plan loans. The PWBA of the Department of Labor, through its website (frequently asked questions), has recently offered its opinion that the SSCRA interest rate provision does apply to plan loans. This position is consistent with the Department of Labor's longstanding view that plan loans should be held to the same standards as other commercial obligations. For example, Department of Labor regulations that define a reasonable rate of interest for plan loans provide, "a loan will be considered to bear a reasonable rate of interest if such loan provides the plan with a return commensurate with the interest rates charged by persons in the business of lending money for loans which would be made under similar circumstances." 29 CFR 2550.408b-1(e). Accordingly, even if SSCRA § 526 is limited to commercial obligations or liabilities, the Department of Labor has taken the position that it nevertheless applies to plan loans.

Forfeiture of Interest Above 6 Percent. It appears to be the view of the Department of Defense and the Department of Justice based on various military pronouncements that a lender must forgive, and not simply postpone, interest in excess of 6 percent during the period of active duty.² Presumably, any federal agency that would issue guidance with respect to the application of SSCRA § 526 to plan loans would adopt a consistent view.

The Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"). USERRA, which gives employment and benefit rights to individuals who are absent from work due to military service, is an overhaul of the Veterans' Reemployment Rights Act of 1940. Under the earlier Act, several questions concerning benefits were unclear. USERRA clarified these issues and some others, but the drafters did not immediately amend the Internal Revenue Code (the "Code") to address potential qualification issues. That was resolved by the Small Business Job Protection Act of 1996, (Pub. L. No. 104-188) which added section 414(u) to the Code to explain how the qualified plan rules should be applied for purposes of USERRA.

Plan Loan Rules Under the Code. With respect to plan loans, section 414(u)(4) of the Code gives a plan the ability to suspend a participant's obligation to repay any loan made to an employee during the period in which an employee is performing service in the uniformed services as defined in USERRA. Under section 414(u)(4), such suspension is not taken into account for purposes of the deemed distribution, qualification, and prohibited transaction sections of the Code. The proposed regulations interpreting section 414(u)(4) issued in July 2000 (section 1.72(p)-1, Q&A-9(b)) provide that an employer is permitted to suspend loan payments during the period in which the employee is performing service in the uniformed services as long as the loan is repaid in full (including interest that accrues during the period of military service) by the end of the period equal to the original term of the loan plus the period of such military service. Although, at this time, there is no reference in either the Code or the underlying regulations to the maximum interest rate provision under SSCRA § 526, it seems unlikely that a good faith

application of the SSCRA would yield adverse tax consequences, particularly in light of the position recently articulated by the PWBA of the Department of Labor. As with USERRA, it may simply be a matter of time before the Code and regulations are in sync with this particular law.

Definition of Military Service Under SSCRA vs. USERRA. It is important to note that SSCRA and USERRA do not have the same definitions for military service. The SSCRA only applies to individuals entering or called to active duty in the military service. Reservists and the members of the National Guard would only be protected under the SSCRA while on active duty. The protection begins on the date a person enters active service and ends on the date that person is released from active service or dies while in active service (SSCRA § 511(2)). Military service under SSCRA also includes training or education under the supervision of the United States preliminary to induction into the military service. The terms "active service" or "active duty" include the period during which a person in military service is absent from duty on account of sickness, wounds, leave, or other lawful cause.³

In contrast, under USERRA, "service in the uniformed services" includes not only active duty service in the armed forces, but also includes inactive duty training, full-time National Guard duty, and a period for which a person is absent from a position of employment for the purpose of an examination to determine the fitness of the person to perform any such duty.⁴ Accordingly, there will be members of the military who will qualify for benefits under USERRA, but not under SSCRA.

Outstanding Issues under SSCRA § 526.

Material Affect. An employer attempting to comply with the maximum rate of interest provision under SSCRA § 526 with respect to participant loans previously incurred by active duty service members should be aware of certain issues. First, as stated above, the 6 percent maximum rate of interest provision under SSCRA does not apply if military service does not "materially affect" the service member's ability to pay interest in excess of 6 percent. The burden is on the lender to make this assertion, and most lenders could simply choose to disregard this burden in the interest of administrative simplicity. However, in the case of a plan covered by Title I of ERISA, an employer or plan administrator acting as fiduciary may have an affirmative obligation to determine whether an individual's ability to pay interest in excess of 6 percent is "materially affected" by military service prior to allowing the 6 percent interest rate. Although the PWBA does not explicitly state this on their website, they do note, "Under SSCRA, a plan fiduciary could petition a court to retain a higher rate based upon the individual's ability to pay" (emphasis provided). A prudent approach may be for an employer to develop administrative procedures to assist in determining whether military service "materially affects" an individual's ability to pay interest in excess of 6 percent before allowing the reduced rate.

Material Affect and Loan Suspension. For those employers who allow participants to suspend plan loan payments during the performance of uniformed services, compliance with SSCRA raises another issue. It is unclear what affect the suspension of loan payments has on the determination of whether the military service "materially affects" a service member's ability to pay interest in excess of 6 percent. Arguably, since section 1.72(p)-1, Q&A-9(b) of the proposed

plan loan regulations requires the participant to pay back all of the interest accrued during suspension, military service could still "materially affect" a service member's ability to pay interest in excess of 6 percent, notwithstanding that the service member is not required to make the payments until after the military service ends. However, this may not always be the case. A prudent approach may be for an employer to make an individual assessment of each affected person's particular circumstances, taking loan suspension into account, before allowing a 6 percent interest rate.

Loan Repayment Following Suspension. If the issue of "material affect" is ultimately resolved in favor of the service member, the loan repayment approach set forth in section 1.72(p)-1, Q&A-9(b) of the proposed regulations can be followed with modification by restricting the interest taken into account during the period of military service to 6 percent. Accordingly, the returning service member would still be required to repay the loan in full (including interest that accrued during the period of military service) by the end of the period equal to the original term of the loan plus the period of such military service. However, the interest that accrued during the period of military service would be limited to a rate of 6%.

Waiver of 6 Percent Interest Rate. Presumably, a service member in a defined contribution plan who is interested in maximizing contributions to his account could waive the 6 percent rate of interest limitation under the SSCRA. Employers should consider whether to implement procedures that provide this choice up front.

Conclusion.

The SSCRA was originally enacted to temporarily suspend legal proceedings and transactions of persons in the military service to enable such persons to devote their entire energy to the defense needs of the Nation. With this purpose in mind, federal agencies are likely to support employers who attempt to implement its provisions in reasonable good faith. Accordingly, although there are some unanswered questions with respect to plan loans and no formal guidance has yet been issued, an employer's reasonable good faith attempts to comply with SSCRA § 526 in the context of plan loans is not likely to generate adverse consequences for either the plan or the employer.

1 Legal Briefs from the Fort Knox Legal Assistance Office, "The Soldiers' and Sailors' Civil Relief Act" (Stating, "...it is the Office of the Judge Advocate General's position that the SSCRA 6% interest cap does not apply to non-commercial obligations and liabilities..."). See <http://knox-www.army.mil/center/sja/pdf/SSCRA.PDF>.

2 Army Lawyer, p. 49, Oct. 1990. See also, Army Lawyer, p. 50, Nov. 1990 (Department of Defense/ Department of Justice position adopted during Desert Shield/Storm by national lending associations [Joint Hearing before the House and Senate Veteran Affairs Committees on SSCRA, 101st Cong., 2d Sess. (12 Sep. 1990)].

3 SSCRA § 511(1).

4 USERRA § 4303(13).

