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The HEART Act: Additional Rules and Opportunities for Plans to Provide Benefits for Employees in Military Service

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Plans are required to be amended in 2010 to reflect the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), which expands the laws governing veterans' reemployment rights and gives employers and plans the opportunity to add additional benefits for former employees in military service. This article provides a brief description of the HEART Act for employers and plan administrators who need to know the rules for providing benefits under the Act.

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), provides for additional benefits and protections for individuals who leave civilian employment for military service. These benefits can affect defined benefit plans, 401(k) plans, and cafeteria plans. A few provisions are mandatory, but most are optional. The Act was signed in 2008, but the effective dates of its provisions vary (between 2007 through 2009). Qualified plans must be amended to reflect compliance with the HEART Act no later than the end of the first plan year beginning on or after January 1, 2010 (2012 for government plans).

Background

Most employers are familiar with the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). USERRA provides

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reemployment rights to employees who voluntarily or involuntarily leave employment for "qualified military service" (generally service in the uniformed services of the United States that contains reemployment rights). An individual who performs military service for five or fewer years and who returns to employment with his or her former employer within the time period specified by law is entitled to be reemployed and reinstated with health care coverage and certain retirement benefits. (These individuals are also entitled to special health coverage continuation rights not discussed in this column.)

Upon reemployment, USERRA treats the individual as having continued to participate in the employer's pension and profit-sharing plans during the period of his or her military service.[1] Internal Revenue Code (IRC) Section 414(u) sets forth how the USERRA rules apply to benefits provided in qualified plans. USERRA prevents a "break in service" for the prescribed period of military service, and treats such service as service with the employer for vesting and accrual purposes if the employee is reemployed upon his or her return from military service. Also, the returning employee may make "catch-up" contributions to the employer's 401(k) plan not exceeding the maximum amount that he or she would have contributed had the individual remained employed during military service, and the employer must provide for any matching or other contributions that would have been made during this period.

The HEART Act expands upon these reemployment rights for persons who die in military service. Such persons would not otherwise be entitled to USERRA benefits as they would not have been able to be reemployed. The HEART Act also provides plans with more flexibility to offer additional benefits to former employees serving in the military.

Required Death Benefits Under Qualified Plans Under the HEART Act

The HEART Act adds IRC Section 401(a)(37), which *requires* that all qualified retirement plans provide a beneficiary of a participant who dies while performing qualified military service with any additional benefits (such as accelerated vesting, ancillary life insurance, or other benefits contingent on the employee's termination of employment on account of death) that would have been provided under the plan had the participant died while in active service of the employer. However, benefit accruals for the period of service between cessation of civilian employment and death are not *required* unless the plan provides otherwise (see below). This provision was retroactive—it applies to deaths occurring on or after January 1, 2007. It also applies to Section 403(b) plans and to Section 457(b) plans of tax-exempt employers and government entities.

IRS Notice 2010-15[2] provides additional guidance for employers on this benefit and the HEART Act. Generally, the mandatory death

benefit only applies to participants who would have been entitled to reemployment rights under USERRA had they applied for such rights before death. If vesting is not immediate upon death (as it is under many plans), Notice 2010-15 provides that vesting service must include qualified military service performed by the individual.

Permitted Credit for Accruals upon Death or Disability

Section 104(b) of the HEART Act adds IRC Section 414(u)(9), which permits, but does not mandate, that an employee who dies or who becomes disabled while actively employed in qualified military service may receive credit for benefit accrual purposes for his or her period of qualified military service. The HEART Act thus treats the individual as having returned to employment and entitled to his or her USERRA reemployment rights on the date of his or her death or disability. This benefit must apply equally to all similarly situated participants, but the employer can choose to provide this additional accrued benefit only with respect to death, disability, or to both events. As noted above, the period of qualified military service must be counted for purposes of vesting for an individual who dies while in service; the plan has the *option* of crediting such service for vesting purposes if the participant is disabled.

For 401(k) plans, the amount of deferrals or employee contributions that are deemed contributed (in order to determine the proper employer contribution if such "accruals" are counted) are based on the individual'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. But if this benefit is provided to a disabled employee who returns to employment and was entitled under USERRA to make up the missed employee contributions and elective deferrals and did so, the plan can use those actual deferrals to determine the HEART Act accrued benefit.

Employers can apply this provision any time on or after January 1, 2007, with the same 2010/2012 required amendment date as described above, or if these optional benefits are added later than 2010/2012, at the time required for such optional plan amendments.

Differential Wage Payments

Effective for remuneration paid after December 31, 2008, the HEART Act amends IRC Section 3401 to treat "differential wage payments" as wages for income tax withholding purposes. Differential wage payments are 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 services in the uniformed services while on active duty for

a period of more than 30 days; and (2) represents all of or a portion of the wage the individual would have received form the employer if the individual were performing services for the employer.

The HEART Act does not *require* payment of differential wages or that such differential wages be used to determine the amount of benefits payable or contributions due to a qualified plan. However, if differential wages are paid, the employee receiving such wages is treated as an employee for retirement plan purposes (because generally plan contributions cannot be made for non-employees). IRS Notice 2010-15 states that such payments are treated as "compensation" under IRC Sections 415(c)(3), 415-2(d), 414(u)(12)(C), and also treats the plan as not failing any nondiscrimination rules by virtue of treating the differential wage payments as compensation. A plan is not required to count such wages in the formula used to calculate the plan benefit. The reason for counting such wages as compensation is to ensure that the statutory ceiling on maximum plan benefits is not exceeded if such payments are counted for purposes of calculating the plan benefit. However, because such wages are included in the defined term "Section 415(c)(3)," employers that pay differential wages should check the terms used in their plan documents to make sure that they do not inadvertently provide for matching or other contributions based on differential wage payments by the use of that term in their document. (An inadvertent inclusion could occur, for example, if the employer pays differential wage payments and the plan provides for a benefit based on all compensation included in income for a plan year.)

Plan Distributions

The HEART Act provides some additional flexibility for plan distributions. It states that an individual is treated as having been severed from employment for purposes of plan distributions even if he or she is receiving differential wage payments during any period that the individual is serving in qualified military service. This treatment is also provided for persons who are performing qualified military service for more than 30 days on active duty. This relief is needed because distributions prior to "severance from employment" are limited under pension plans and 401(k) and 403(b) plans. However, if a participant elects to receive such a distribution based on this relief, he or she may not make an elective deferral or employee contribution to the plan during the six-month period beginning on the date of the distribution. If the participant has actually severed employment and does not need this relief, the six-month suspension does not apply.

The HEART Act also amended IRC Section 72(t) permanently to allow for an in-service distribution of elective deferrals under Section 401(k) or 403(b) for "qualified reservist distributions." This provision was due to expire in 2007.

Cafeteria Plans—Distributions of Unused Health FSA Money to Activated Reservists

The HEART Act contains a special exception to the well-known "use it or lose it rule" for cafeteria plans—it allows distributions of unused amounts in a health flexible spending arrangement (health FSA) to reservists ordered or called to active duty. This rule applies to distributions made on or after June 18, 2008.

Generally, new Subsection 125(h) provides that a plan or other arrangement does not fail to be a cafeteria plan or health FSA merely because the arrangement provides, in certain circumstances, for qualified reservist distributions (QRDs) to an employee of all or a portion of the balance of the employee's unused amounts in the health FSA. A cafeteria plan is not required to provide for a QRD; the decision of whether to allow a QRD from a health FSA is optional with the employer.

A QRD may not be made before the cafeteria plan is amended to provide for a QRD from a health FSA. Pursuant to the requirements of Proposed Treasury Regulations Section 1.125-1(c), a plan may be amended at any time on a prospective basis. The QRD amendment must apply uniformly to all participants in the cafeteria plan. Notwithstanding the general rule that amendments to cafeteria plans and health FSAs may only be effective prospectively from the date of the plan amendment and that a QRD may not be made before the cafeteria plan is first amended to provide for QRDs, a plan was able to be amended retroactively to permit QRDs requested on or before December 31, 2009. The retroactive amendment must have been made by December 31, 2009, and be effective retroactively to the date of the first QRD paid under the plan, but not prior to June 18, 2008.

Roth IRA and Coverdale Contributions

The veterans' rights law provides for certain military death gratuities and insurance payments for eligible survivors of a service member. The HEART Act amended the Internal Revenue Code to allow beneficiaries of such gratuities or payments to roll over these amounts to a Roth IRA if the contribution is made before the end of the one-year period beginning on the date on which the IRA beneficiary receives the military death gratuity or insurance payment, or if later, by June 17, 2009. Such gratuities or payments can also be made to a Coverdale Education Savings Account (ESA). The limits on Roth IRA or Coverdale ESA contributions do not apply to the contributions.

Conclusion

Plan amendments for HEART Act changes should be made on or before the last day of the 2010 plan year (2012 for government plans).

Cafeteria plan amendments must be made before the provision is put into effect. Many employers may need to amend their retirement plans to ensure that their definitions of plan compensation and withdrawal provisions comply with the HEART Act. Most of the current plan documents reflecting USERRA merely cross reference the statute, and now that additional options are available, it will be important to ensure that the plan operates as intended with respect to qualified military service. Plan administrators should also review their administrative procedures and election forms to ensure that the rules of USERRA and the HEART Act are properly reflected.

Notes

1. *See* Moran, Terrill, and Kolomeitz, "Protections for Employees Called in Military Service," *Employee Relations Law Journal*, vol. 27, no. 4 (Spring 2002).

2. 2016-6 IRB 390 (Jan. 20, 2010).

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