

HEART Act Military Leave Guidance: Impact on 401(k) Accruals, Distributions

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The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) requires employers to provide certain retirement and welfare benefits for returning military personnel and their beneficiaries. On Jan. 20, 2010, the Internal Revenue Service issued **Notice 2010-15**, which provides long-awaited guidance in the form of questions and answers on several HEART Act provisions, including survivor benefits, benefit accruals, differential pay and distributions.

Survivor Benefits

If a participant in a 401(k), 403(b) or 457(b) defined contribution retirement plan dies while performing qualified military service, the HEART Act requires that:

- The plan provide the participant's survivor with any additional benefits (other than benefit accruals) to which the participant would have been entitled had he or she resumed active employment and then terminated employment on account of death.
- Such additional benefits may include accelerated vesting, ancillary life insurance benefits or other survivor benefits provided under the plan that are contingent on the participant's termination of employment attributable to death.

Notice 2010-15 reiterates that benefit accruals are excluded from the additional benefits to which survivors are entitled. However, a plan must provide vesting service credit during qualified military service if a participant dies during such service. Unlike survivor requirements, a plan is not required to provide vesting credit to individuals who become disabled while performing qualified military service. However, plans are not prohibited from doing so as long as such vesting service credit applies to all similarly situated participants.

Benefit Accruals

Although plans are not required to do so, under the HEART Act a plan may treat an individual who dies or becomes disabled while performing qualified military service as if he or she resumed employment and then terminated employment on account of death or disability. In essence, this permitted treatment allows a plan to provide additional benefit accruals to an individual who dies or becomes disabled while performing qualified military service.

To calculate the additional benefit accruals under contributory arrangements such as 401(k) plans, Notice 2010-15 clarifies that:

- The amount of elective deferrals and employee contributions to be taken into account is the average of the individual's actual contributions for the 12-month service period immediately preceding qualified military service (or, if less than 12

months, the actual length of continuous service with the employer).

- A plan must provide additional benefit accruals on reasonably equivalent terms to all participants performing qualified military service. This provision may be effective at any time on or after Jan. 1, 2007.

Differential Wage Payments

If an individual is called to active military duty after Dec. 31, 2008, for a period of more than 30 days, any employer wage payments to this individual will be treated as "differential wage payments" to the extent that the payments represent wages the individual would have received had he or she not been called to active military duty. The HEART Act requires that individuals receiving differential wage payments be considered employees of the employer making the payment and mandates that such payments be included in wages for income tax withholding purposes.

Notice 2010-15 clarifies that:

- Differential wage payments may be, but are not required to be, treated as compensation for purposes of determining contributions and benefits under a plan.
- Such payments are required to be treated as compensation under the plan when applying other provisions of the tax code.

For instance, differential wage payments must be treated as compensation for purposes of applying the maximum benefit and contribution limits of section 415 of the tax code. Additionally, the IRS guidance explains that benefits provided as a result of differential wage payments may be included in a plan's nondiscrimination testing as long as such payments are provided to participants on reasonably equivalent terms.

Distributions

The HEART Act provides that a plan may treat an individual who is called to active duty for more than 30 days as having been severed from employment during the period of active duty for purposes of being eligible to receive a distribution, including distributions from a designated Roth account under section 402A of the tax code. If an active duty participant elects to receive a 30-day deemed distribution, the 10 percent penalty tax for early distributions applies, and the participant cannot make elective deferral or employee contributions for six months beginning on the date of distribution. A 30-day deemed distribution must be considered an eligible rollover distribution.

Notice 2010-15 clarifies that:

- The 30-day deemed distribution provision is permissive and may apply regardless of whether an individual is receiving differential wage payments.
- This provision does not affect the status of individuals who have experienced an actual severance from employment, nor does it affect a plan's ability to make other in-service distributions permitted under the plan.

The HEART Act extends indefinitely qualified reservist distributions, which are distributions of 401(k) or 403(b) elective deferrals to members of the reserves who have been called to active duty for more than 179 days or indefinitely. Qualified reservist distributions

generally are not subject to the normal restrictions on in-service distributions.

If a participant receives a qualified reservist distribution, Notice 2010-15 explains that:

- The distribution will not be subject to in-service distribution restrictions even if it would also qualify as a 30-day deemed distribution as described above.
- Therefore, the distribution therefore will not be subject to the six-month restriction on elective deferrals or to the additional 10 percent penalty tax for early distributions.

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