



eBenefits Alert: Recently Passed Heroes Earning Assistance and Relief Tax Act Will Require Some Changes to Retirement and Welfare Plans

June 1, 2008

On June 17th, the Heroes Earnings Assistance and Relief Tax Act, or HEART was signed into law by the President after having been unanimously approved by both chambers of Congress. The Act provides tax relief for workers engaged in active military service and miscellaneous tax relief and offset provisions. The Act will require some changes to retirement and welfare plans.

The following briefly summarizes the employee benefits related provisions of HEART:

Survivor Benefits: *Plan Amendment Required*

Tax qualified plans must provide that if a participant dies while performing "qualified military service," his or her survivors are entitled to any benefits the participant would have been provided had he or she resumed employment and then terminated due to death. For example, if a plan accelerates vesting upon the death of a participant, a participant who dies while performing "qualified military service" must receive accelerated vesting of any unvested accrued benefits as though the participant was employed on his or her date of death. This change applies to all tax-qualified plans and similar rules apply to Code section 403(b) annuities and Code section 457(b) plans. This requirement applies for deaths occurring on or after January 1, 2007 but plans have until the last day of the 1st plan year beginning on or after January 1, 2010 (December 31, 2010 for calendar year plans) to be amended.

Benefit Accruals: *Plan Amendment Allowed, but not Required*

Plans may treat a participant who cannot be reemployed due to death or disability resulting from active military service as a "deemed rehired employee" for purposes of benefit accruals. Thus, employers may credit a participant with contributions that would have been required under Code section 414(u) had the participant actually resumed employment without violating otherwise applicable Code limitations. (Code section 414(u) generally requires plans to credit reemployed participants with matching contributions for elective deferrals that the participant would have made during the period of their qualified military service to the extent the participant actually makes payment to the plan with respect to such deferrals upon reemployment.) If a plan chooses to treat an employee as rehired, the plan must determine the rate of



employee contributions or elective deferrals using the actual average contributions or deferrals made by the employee during the 12-month period prior to the participant's military service or, if less, the actual length of continuous service prior to the participant's military service. To take advantage of this provision, the plan must treat all individuals performing qualified military service on a reasonably equivalent basis and cannot discriminate in favor of highly compensated employees. This change applies to deaths or disabilities occurring on or after January 1, 2007.

Definition of Compensation: *Plan Amendment Required*

Effective for remuneration paid on or after January 1, 2009, "differential pay" will be treated as wages subject to income tax withholding. In turn, "differential pay" will be required to be treated as compensation for retirement plan purposes. "Differential pay" is defined in HEART as any payment which is (1) made by an employer to individuals with respect to any period during which they are performing active military service for more than 30 days; and (2) represents all or part of the wages the individual would have received from the employer if they were performing services for the employer. Plans have until the last day of the 1st plan year beginning on or after January 1, 2010 (December 31, 2010 for calendar year plans) to be amended.

Distribution of Elective Deferrals: *Operational Change, No Plan Amendment Necessary*

Effective January 1, 2009, a participant who is on active military duty for more than 30 days will be treated as having terminated employment for purposes of receiving certain distributions from 401(k) plans, 403(b) annuities and 457(b) deferred compensation plans. Thus, participants on active military duty will be permitted to take a distribution from such plans as though they have experienced a severance from employment. If a participant takes a distribution pursuant to this provision, the distribution will not be subject to the additional 10% tax under Code section 72 but the participant will be barred from making elective deferrals or employee contributions for six months following the distribution.

In addition to the above change, HEART made permanent the Pension Protection Act provision that waives the 10% tax under Code section 72 for "qualified reservist distributions."

Health FSA Distributions: *Plan Amendment Allowed, but not Required*

A cafeteria plan may now permit a "qualified reservist distribution" of all or a portion of a participant's FSA balance. A "qualified reservist distribution" is a distribution to a participant that is a reservist called to active duty for a period of at least 180 days (or for an indefinite period) that is made during the period beginning with the call to active duty and ending on the last day of the coverage period of the FSA that includes the date of the call to active duty. This provisions is effective for distributions made after the HEART enactment date.



Mental Health Parity Extension

The Internal Revenue Code, the Employee Retirement Income Security Act ("ERISA") and the Public Health Service Act ("PHSA") contain provisions under which group health plans that provide both medical and surgical benefits and mental health benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits (the "mental health parity requirements"). The Code imposes an excise tax on group health plans that fail to meet the mental health parity requirements. These provisions had expired with respect to benefits for services furnished after December 31, 2007. HEART extends the mental health parity requirements and corresponding excise tax for benefits furnished on or after the date of enactment through December 31, 2008.

Please contact a member of the Gray Plant Mooty Employee Benefits and Executive Compensation group for more information about HEART and how it may affect your retirement plan.

This article is provided for general informational purposes only and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult a lawyer concerning any specific legal questions you may have.