



Pension Analyst

For immediate action

Legislation

August 2008

HEART Act provides additional private pension benefits to members of the military

Who's affected

This new law applies to sponsors of and participants in qualified defined benefit and defined contribution plans, including multiemployer plans, governmental plans, and church plans that do not elect to be covered by ERISA ("non-electing church plans"). It also applies to section 403(b) arrangements and section 457(b) plans.

Background and summary

On June 17, 2008, President Bush signed into law the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act). This law provides additional tax and pension benefits to individuals who are absent from work due to duty in uniformed military service.

Some provisions are effective retroactively to January 1, 2007. Other provisions are first effective for 2009 plan and tax years. Plans must be operated in accordance with the new rules as of the appropriate effective dates.

In general, plans must be amended to reflect the required provisions of the HEART Act by the last day of the first plan year beginning on or after January 1, 2010. The deadline for amending governmental plans to reflect these provisions is the last day of the first plan year beginning on or after January 1, 2012.

Action and next steps

Plan sponsors should review the information contained in the publication and identify the provisions that apply to their plans. While plans do not have to be amended immediately to reflect these provisions, plan sponsors must operate their plans in accordance with the new rules and may need to identify participants who died or became disabled while on military leave on or after January 1, 2007.

In this issue

- [Provisions effective in 2007](#)
- [Special tax treatment of Qualified Reservist Distributions](#)
- [Provisions effective in 2009](#)
- [Action required](#)

All private and governmental employers must comply with the Uniformed Services Employment and Reemployment Rights Act (USERRA), which provides special employment and [benefit rights](#) to individuals who leave employment to perform qualified military service.

"Qualified military service" is service in the uniformed services while on active or inactive duty, including training periods. "Uniformed services" include the Army, Navy, Air Force, Marines, Coast Guard, Reserves, Army and Air National Guards, the commissioned corps of the Public Health Service, and any other persons designated by the President.

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The HEART Act clarifies some of the USERRA requirements that apply to employer-sponsored retirement programs. It also makes permanent a limited excise tax exemption that was provided under the Pension Protection Act of 2006 (PPA).

Provisions effective in 2007

The HEART Act contains two provisions that are effective retroactively to January 1, 2007. One is a required provision, while the other is an optional provision.

The new law *requires* sponsors of qualified defined benefit and defined contribution plans, 403(b) arrangements, and governmental section 457(b) plans to treat participants who die on or after January 1, 2007, while performing qualified military service as being reemployed and then dying for purposes of entitlement to certain additional benefits under the plan. This requirement applies to provisions such as:

- Accelerated (i.e., 100%) vesting on account of death while an active employee;
- Eligibility for ancillary life insurance benefits; and
- Other survivor benefits that are available only when a participant dies while an active employee of the plan sponsor.

The law also *permits* sponsors of qualified defined benefit and defined contribution plans, 403(b) arrangements, and section 457(b) plans to treat participants who die or become disabled on or after January 1, 2007, while performing qualified military service as:

- Having been rehired as of the day before his death or disability; and then
- Terminating employment on the date of death or disability.

The plan *may* provide full or partial benefit accruals or contributions for the period of such a participant's absence, [as would have been required by USERRA](#) if the participant had actually been rehired. However, the same benefits or contributions must be provided for all similarly situated participants on a reasonably equivalent basis.

Special tax treatment of Qualified Reservist Distributions

The Pension Protection Act of 2006 (PPA) provided special tax treatment for qualified reservist distributions made to certain individuals called to active duty before December 31, 2007. The HEART Act makes this special treatment permanent by extending it to individuals called to active duty on and after December 31, 2007.

A "qualified reservist distribution" is a distribution:

- Of elective deferral contributions made from a 401(k) plan or 403(b) arrangement;
- Made to an individual who was ordered or called to active duty in the Reserves or National Guard for a period exceeding 179 days, or an indefinite period; and
- Made during the period beginning on the date of the call-up order and ending at the close of the active duty period.

These distributions are exempt from the 10% early withdrawal penalty tax. In addition, an individual may re-contribute all or part of his qualified reservist distributions to an IRA at any time during the two-year period beginning on the day after the end of his active duty period. Multiple repayments may be made, but repayments may be made only to IRAs, even if the distributions came from a 401(k) plan or 403(b) arrangement.

Provisions effective in 2009

Some employers pay differential pay to their employees who are called to active duty in the uniformed services. "Differential pay" is the difference between the individual's pay from the employer and his military pay. Currently, differential pay is not treated as wages for federal income tax withholding rules, but is reported on Form 1099-MISC. The HEART Act revises the federal income tax withholding rules to treat differential pay paid after December 31, 2008, as wages.

In addition, differential pay paid after December 31, 2008, must be treated as compensation for retirement plan purposes. As a result:

- Employees must be allowed to make contributions to qualified defined benefit and defined contribution plans, 403(b) arrangements, and section 457(b) plans based on differential pay;
- Plan sponsors must include differential pay when calculating plan benefits and contributions.

The HEART Act also provides special distribution options for certain employees who are receiving differential pay after December 31, 2008. Under the new rule, an individual who is receiving military differential pay for an active duty period of more than 30 days must be treated as having terminated employment for purposes of eligibility to receive a distribution of 401(k), 403(b) or 457(b) elective deferrals. However, an individual who takes such a distribution cannot make elective deferral or employee post-tax contributions to the plan during the six-month period beginning on the date of distribution.

Action required

Plan sponsors should review their plan provisions to determine if additional benefits (such as accelerated vesting) are payable to employees who die while actively employed. If your plans contain such provisions, you need to determine if any employees on military leave died on or after January 1, 2007, while performing qualified military service. These employees may be due additional plan benefits.

Plan sponsors must also decide how to handle benefit accruals for employees who die or become disabled while on military leave on or after January 1, 2007.

It is important to note that the law itself does not indicate how these additional accrual requirements apply to defined benefit plans that are frozen or that are in "at risk" status and cannot provide additional accruals. Hopefully, the IRS will provide guidance in this regard.

Beginning January 1, 2009, plan sponsors will need to identify employees who are receiving differential pay so they will continue to be able to make deferral and employee post-tax contributions from this pay and are also able to take distributions of 401(k), 403(b) or 457(b) elective deferral contributions.

In general, plans must be amended to reflect the HEART Act provisions by the last day of the first plan year beginning on or after January 1, 2010. The deadline for amending governmental plans to reflect these provisions is the last day of the first plan year beginning on or after January 1, 2012. If Prudential Retirement provides document services for your plan, we will work with you to ensure that your document complies with the applicable amendment deadline.

The chart below summarizes the pension provisions of the HEART Act and identifies affected plans and applicable effective dates.

Plans affected				Effective date	Provision
DB	DC	403(b)	457(b)		
DB	DC	403(b)	Gov'tal	Deaths occurring on or after 01/01/2007	A participant who dies while performing " qualified military service " must be treated as being reemployed and then dying for purposes of entitlement to additional benefits such as: <ul style="list-style-type: none"> • Accelerated (100%) vesting; • Ancillary life insurance benefits; • Other survivor benefits available only when a participant dies while an active employee of the plan sponsor.
DB	DC	403(b)	457(b)	Deaths and disabilities occurring on or after 01/01/2007	A participant who dies or becomes disabled while performing " qualified military service " and cannot be rehired may be treated as having been rehired as of the day before his death or disability and then terminating employment on the date of death or disability. The plan may provide full or partial benefit accruals or contributions for the period of absence, as long as the same benefits or contributions are provided for all similarly situated participants on a reasonably equivalent basis.
DB	DC	403(b)	457(b)	Differential pay paid in Years beginning after 12/31/2008	" Differential pay " must be treated as "wages" for federal income tax withholding purposes (i.e., reported on Form W-2) and as "compensation" for retirement plan purposes. <ul style="list-style-type: none"> ⇒ Employees must be allowed to make contributions to plans based on differential pay; ⇒ Employers must include differential pay when calculating plan benefits and contributions.
	401(k)	403(b)	457(b)	Years beginning after 12/31/2008	An individual who is receiving " differential pay " for an active duty period of more than 30 days must be treated as having terminated employment for purposes of eligibility to receive a distribution of 401(k), 403(b) or 457(b) elective deferrals. An individual who takes such a distribution cannot make elective deferrals or employee post-tax contributions to the plan during the 6-month period beginning on the date of distribution.
	401(k)	403(b)		Individuals called to active duty on or after 12/31/2007	The 10% additional tax on early distributions is permanently waived for " qualified reservist distributions " made to individuals who are called to active duty and serve more than 179 days.

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