



# Pension Analyst

Important information

Plan administration and operation

April 2010

## IRS provides guidance on miscellaneous HEART Act changes

### Who's affected

This guidance 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 403(b) plans and section 457(b) plans.

### Background and summary

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) was signed into law in June 2008, to provide additional tax and pension benefits to individuals who are absent from work due to duty in the uniformed military service. Some provisions of this law were effective in 2007, while other provisions became effective in 2009. In addition, some provisions are mandatory, while others are optional. In general, the deadline for amending plans to reflect the mandatory provisions of this law is the last day of the first plan year beginning on or after January 1, 2010. The deadline for amending governmental plans is the last day of the first plan year beginning on or after January 1, 2012.

On February 8, 2010, the IRS published [Notice 2010-15](#) to provide guidance on certain retirement plan-related provisions of the HEART Act. This guidance addresses:

- Survivor and disability benefit requirements;
- The treatment of differential pay for plan purposes;
- Special plan distribution provisions applicable to individuals who are performing qualified military service; and
- Plan amendment requirements.

### Action and next steps

Plan sponsors should review the information contained in this publication and identify those items that apply to their plans. If an interim amendment has already been adopted to reflect certain HEART Act provisions, additional amendments may be needed or desired to reflect this new guidance.

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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 Guard, the commissioned corps of the Public Health Service, and any other persons designated by the President.

The HEART Act clarified and expanded on some of the USERRA requirements that apply to employer-sponsored retirement programs.

## Survivor and disability benefits

Qualified plans, 403(b) plans and governmental section 457(b) plans *must* 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. These additional benefits include accelerated vesting, ancillary life insurance benefits, and other benefits that are contingent upon the participant’s termination of employment due to death.

The new guidance clarifies that if a participant was not entitled to reemployment rights under USERRA immediately before his death, the plan is not required to provide vesting service for his period of military service or the other benefits that become available upon the death of an active participant. A participant would not have USERRA reemployment rights if he did not provide advance notice of his military service to the employer or had more than 5 years of cumulative service in the uniformed service while with that employer.

## Vesting service

In general, a plan *must* provide vesting service credit for a *deceased* participant’s period of qualified military service.

However, plans are *not required* to provide additional vesting to an individual who becomes *disabled* while performing qualified military service. Plans that wish to provide additional vesting service would have to do so in accordance with the imputed service crediting rules. According to this new guidance, imputed vesting service credited to such an individual is deemed to satisfy the imputed service crediting rules as long the plan provision crediting the service applies to all similarly-situated employees.

## Benefit accruals

In addition, qualified plans, 403(b) plans and section 457(b) plans *may* treat participants who die or become disabled on or after January 1, 2007, while performing qualified military service as being reemployed on the day before their death or disability and terminating employment on their date of death or disability (“deemed reemployed”), for purposes of accruing additional benefits. The new guidance clarifies that this type of provision may be made effective as of any date on or after January 1, 2007. In addition, these accruals must be provided on reasonably equivalent terms to all participants performing qualified military service.

## Calculating additional accruals

In general, a plan sponsor that chooses to provide contributions or benefit accruals for deemed reemployed participants will calculate those benefits based on a participant’s deemed post-tax or pre-tax contributions. Under this provision, the individual is deemed to have made post-tax or pre-tax contributions in an amount equal to the lesser of:

- The average actual contributions he made under the plan during the 12-month period preceding his departure for military service; or
- If he had less than 12 months of service with the employer before entering military service, the average actual contributions he made during his actual length of continuous service with the employer.

In this notice, the IRS confirms that a plan that allows disabled individuals to make post-tax or pre-tax contributions may allow a disabled individual who is deemed reemployed to make these contributions for his period of military service. In addition, the plan *may*, but is not required to, determine related employer contributions or benefit accruals based on the contributions actually made by the individual.

## Differential wage payments

Some employers make differential wage payments to their employees who are called to active duty in the uniformed services. "Differential wage payments" (or "differential pay") are typically the difference between the individual's normal pay from the employer and his military pay. Employers are not required to make these wage payments, but for those that do, the HEART Act changed their tax treatment.

Under the HEART Act, differential wage payments made after December 31, 2008, are considered W-2 wages. As a result, individuals receiving such payments are considered to be active employees of the employer. The new IRS guidance clarifies the following points regarding these payments:

- Differential pay does not have to be counted as compensation for contribution or benefit accrual purposes.
- A plan that uses the W-2 wages definition of compensation for contribution or benefit accrual purposes may exclude differential pay from that definition for this purpose and will still be considered to have a nondiscriminatory definition of compensation.
- For purposes of applying the section 415 Annual Additions and Annual Benefits limits, compensation *must* include differential pay.
- Contributions and benefits provided as a result of differential pay do not have to be included in nondiscrimination testing. However, they *may* be included in this testing, as long as they are included for all similarly-situated employees and do not cause the plan to fail the applicable test (e.g., the ADP Test).

## Special distribution provisions

The HEART Act contained two special distribution provisions for individuals who are performing military service.

First, it made permanent the qualified reservist distribution provisions originally enacted by the Pension Protection Act of 2006. 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.

In addition, it provided a special distribution option for certain individuals. Under this provision, individuals who are receiving differential wage payments after December 31, 2008, are treated as terminated employees for purposes of eligibility to receive distributions of 401(k) or 403(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.

Notice 2010-15 provides the following additional insights regarding these special distribution provisions:

- For distribution purposes, an individual is treated as having terminated employment during any period of active duty service in the uniformed services that exceeds 30 days (i.e., "deemed terminated"), regardless of whether he is receiving differential pay.
- Plans do not have to make distributions available to deemed terminated participants.
- An individual who actually terminates his service with the employer to go on active duty is not subject to the 6-month deferral suspension rule that applies to deemed terminated employees who receive distributions of elective deferral contributions. As a result, if he is reemployed within 6 months of taking a distribution of elective deferrals due to his actual termination of employment, he may immediately begin making new deferral contributions.
- If an individual is eligible to take either a qualified reservist distribution or a distribution on account of deemed termination, his distribution will be considered a qualified reservist distribution and will not be subject to either the 6-month deferral suspension or the 10% additional penalty tax for premature distribution.
- In general, a distribution made on account of deemed termination is an eligible rollover distribution that is subject to 20% withholding if not directly rolled over.

## Plan amendments

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 (January 1, 2012, for governmental plans).

In general, plan sponsors must adopt discretionary amendments reflecting *permissive* provisions that they wish to incorporate into their plans by the last day of the plan year in which the amendments are effective. However, the new IRS guidance provides that the earliest date a plan must be amended to adopt any of the permissive HEART Act provisions is the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans), even if the actual effective date is much earlier.

If Prudential Retirement provides document services for your qualified defined benefit or defined contribution plan, you should already have received a Pension Protection Act (PPA) Amendment that reflects the basic HEART Act provisions, based entirely on the provisions of the Act itself. Additional amendments may be needed to reflect this new guidance, as noted below. Prudential's document services for 403(b) and 457(b) plans are also discussed below.

### Defined benefit plans

For defined benefit plans, the only optional provision that was not incorporated into your PPA Amendment is the [disability vesting service](#) provision discussed above. If you wish to incorporate this optional provision into your plan document, please contact the Pension Consultant who provided you with the PPA Amendment.

### Defined contribution plans

Prudential's volume submitter document will be amended to include the various optional provisions and to add clarifying language reflected in Notice 2010-15. We anticipate that we will combine the HEART Amendment with the [WRERA amendment](#) and intend to mail this amendment this fall.

Prudential's prototype document will also be amended to incorporate the additional language of Notice 2010-15. This amendment will be mailed to you later this year with the WRERA amendment.

### 403(b) and 457(b) plans

Prudential is in the process of preparing amendments for 403(b) documents to support HEART provisions such as death benefits, benefit accruals for death or disability, differential military pay and qualified reservist distributions. This amendment will be available shortly.

Prudential is also revising the 457(b) document to include optional provisions applicable to governmental and tax-exempt documents such as benefit accruals for death or disability and differential military pay.

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#### Pension Analyst by Prudential Retirement

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