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IRS Provides HEART Act Retirement Plan Guidance

On January 20, 2010, the IRS issued Notice 2010-15 relating to the Heroes Assistance and Relief Tax Act of 2008 (the "HEART Act") and addressed issues relating to differential pay, vesting, in-service distributions and other issues.

Differential Pay

The notice clarifies that differential wage payments to employees in qualified military service "are not required to be treated as compensation for purposes of determining contributions and benefits under a plan." However, military differential pay must be treated as compensation for I.R.C. §415 (benefit limitation) purposes. Finally, excluding differential pay will not cause a plan's compensation definition to be treated as discriminatory under I.R.C. §414(s).

> ***Comment**: This is helpful, particularly for final pay defined benefit pension plans, where recognizing differential pay for benefit purposes could reduce benefits.*

Vesting

The HEART Act mandates that the survivor of a participant who dies while in qualified military service will be entitled to any additional benefits (other than accruals during the period of qualified military service) that would be provided under the plan if the participant had resumed employment and then terminated employment due to death.

The HEART Act also permits (but does not require) plans to accrue benefits for participants in qualified military service (with reemployment rights) who die or become disabled during their period of military service. An open question has been whether vesting service must (or may) also be recognized.

The notice provides that if a participant ***dies*** during a period of qualified military service, his/her period of military service must be counted for vesting purposes, regardless of whether the plan accrues benefits for the period of military service.

On the other hand, the notice provides that if a participant ***becomes disabled*** during a period of qualified military service, then the period of military service does not need to be counted for vesting, even though the plan accrues benefits for the period of military service. This is because I.R.C. §414(u)(9) provides for permissive benefit accruals during a period of military service in which a participant becomes disabled, but does not specifically address vesting service during the same period. The notice indicates that vesting during a period of qualified military service during which a participant becomes disabled may be recognized for vesting under other applicable qualified plan rules, including the imputed service nondiscrimination rules in Treas. Reg. §1.401(a)(4)-11(d)(3).

***Comment**: If an employer elects to accrue benefits for a participant who becomes disabled while in qualified military service, the plan should also recognize the same period of military service for vesting purposes, particularly in defined benefit plans that may require a minimum number of years of service as a condition to entitlement to plan disability benefits.*

In-Service Distributions

The HEART Act includes two in-service distribution provisions.

First, a **"qualified reservist distribution"** of elective deferrals or after-tax employee contributions from a 401(k), 403(b) or 457(b) plan may be made to individuals called to active military duty after September 11, 2001 for 180 days or more. A qualified reservist distribution is not subject to the ten percent excise tax under I.R.C. §72(t).

Second, an individual who is called to active military duty for more than 30 days may be deemed to have severed employment for the purpose of electing withdrawals of elective deferrals of employee after-tax contributions from a 401(k), 403(b) or 457(b) plan. If a participant makes a withdrawal under this provision, then he/she cannot make any elective deferral contributions or after-tax employee contributions to the plan for the next six months and the ten percent excise tax under I.R.C. §72(t) will apply to the withdrawal. This is referred to as a **"deemed severance distribution"**.

The notice indicates that if a plan provides for both qualified reservist distributions and deemed severance distributions, and the participant's withdrawal is authorized under either provision, the withdrawal will be treated as a qualified reservist distribution. Therefore, the withdrawal will not be subject to either the six month suspension of elective deferrals (or after-tax employee contributions) or the ten percent excise tax.

***Comment**: 401(k), 403(b) and 457(b) plans do not need to provide for both qualified reservist distributions and deemed severance distributions. This special rule illustrates why the better plan design may be to only provide for qualified reservist distributions.*

Other Guidance in Notice 2010-15

The notice also includes guidance with respect to HEART Act provisions relating to: (1) the contribution of military death gratuities or service members group life insurance proceeds to Roth IRA or Coveredell education accounts; and (2) the small employer tax credit for differential wage payments.

Here is a link to IRS Notice 2010-15: http://www.irs.gov/pub/irs-drop/n-10-15.pdf.

Please let us know if you have any questions, or if we can be of assistance.

January 28, 2010