

February 08, 2010

TCRS 2010-02: IRS Issues Guidance on Miscellaneous HEART Act Changes

On January 20, 2010, the Internal Revenue Service (IRS) released Notice 2010-15 providing guidance in question and answer format relating to certain provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act). The IRS is also requesting comments regarding any additional issues relating to these provisions. Notice 2010-15 is being published in the Federal Register today, February 8, 2010.

Scope of Notice 2010-15

Notice 2010-15 provides guidance on the HEART Act rules dealing with the survivor and disability payments with respect to qualified military service, treatment of differential military pay as wages, distributions from retirement plans to individuals called to active duty, contributions of military death gratuities to Roth IRAs and Coverdell Education Savings Accounts (ESAs), and employer credits for differential wage payments to employees who are active duty members of the uniformed services.

Notice 2010-15 also contains the rules for required amendments to comply with these HEART Act provisions.

Background

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), an individual who leaves the employment of a civilian employer for qualified military service is generally entitled to re-employment with that employer if the individual is re-employed within a specified period and meets the re-employment criteria under USERRA. Upon the individual's re-employment, USERRA provides that the individual is entitled to certain pension, profit sharing and similar benefits that would have been received had the individual not entered military service.

While USERRA was enacted to protect the re-employment rights of those who leave employment to serve in the military, the HEART Act amended USERRA to provide benefits and vesting protection for those who could not return to work because of death or disability while performing military service.

The highlights of the HEART Act guidance contained in Notice 2010-15 are explained below in section number order.

Section 104 – Survivor and Disability Payments with Respect to Qualified Military Service

- Internal Revenue Code (IRC) section 401(a)(37), as added by section 104(a) of the HEART Act provides that if a participant in a qualified retirement plan dies while performing qualified military service, his/her survivors will be entitled to any additional benefits (other than benefits accrued during the period of qualified military service) that would have been provided to the participant had his/her employment resumed and then terminated on account of death. Qualified military service is any service in the uniformed services by an individual entitled to re-employment rights under USERRA. This provision also applies to section 403(b) plans and eligible governmental plans under IRC section 457(b).
- The types of benefits covered by IRC section 401(a)(37) include accelerated vesting, ancillary life insurance benefits, and other survivor benefits that are contingent upon termination of employment on account of death.
- IRC section 401(a)(37) does not require that benefit accruals or contributions for the period of qualified military service be imputed for purposes of determining death benefits.

- Providing service credit for vesting for an individual who dies during a period of qualified military service is mandatory and the service credit counts in calculating the individual's vesting percentage during the period of military service and during other periods.
- By contrast, service credit for vesting for an individual who becomes disabled while performing military service may be provided, but is not required.
- Under IRC section 414(u)(9) as added by section 104(b) of the HEART Act, it is optional for benefit accrual purposes, for an employer to treat an individual who dies or becomes disabled while performing qualified military service as though the individual had resumed employment in accordance with USERRA. However, if the employer chooses to treat an individual as having resumed such employment, it must treat all individuals similarly situated on a reasonably equivalent basis.
- If a plan permits employee contributions or elective deferrals, and an individual dies or becomes disabled while performing qualified military service, he/she is treated as having made employee contributions or elective deferrals, in the amount described below, for the purpose of determining any employer-provided contributions or benefits that are contingent on having made the employee contributions or elective deferrals, such as employer matching contributions. Such amount is equal to the lesser of the actual average employee contributions or elective deferrals made by the individual during the 12-month period immediately prior to military service or, if less, the actual length of continuous service with the employer. Notice 2010-15 further provides that if a plan allows a disabled individual to contribute make-up employee contributions or elective deferrals, the employer-provided contributions or benefits may be based on the actual contributions made by the disabled individual.

Section 105 – Treatment of Differential Military Pay as Wages

- Under IRC section 3401, as amended by section 105(a) of the HEART Act, differential wage payments are treated as wages for income tax withholding purposes. A differential wage payment is any payment made by an employer to an individual during a period of active military duty for more than 30 days and the payment represents all or a portion of the wages the individual would have received if his employment with the employer continued. This amendment to IRC section 3401 applies to remuneration paid after December 31, 2008. For purposes of applying the IRC to retirement plans subject to the special rules relating to veteran's reemployment rights under USERRA with respect to differential wage payments to service members on active duty, the individual is treated as an employee of the employer making the differential wage payment and such payments are treated as compensation.
- Notice 2010-15 provides that differential wage payments and the ability to make contributions based on such payments must be made available to all employees on reasonably equivalent terms.
- Contributions and benefits provided as a result of differential wage payments need not be included in a plan's nondiscrimination testing. But, if such benefits and contributions are taken into account for any employee, they must be taken into account for all employees.
- Differential wage payments are not required to be treated as compensation for calculating benefits and contributions under a plan, but are treated as compensation for purposes of the annual limitation on benefits and contributions under IRC section 415.
- The Notice makes clear that a plan will not fail the compensation ratio test of IRC section 414(s) just because differential wage payments are excluded from compensation used to calculate plan contributions and benefits.
- For purposes of the rules that apply to IRC sections 401(k), 403(b) and 457(d) plans permitting distributions upon severance from employment, an individual is treated as having severed from employment (deemed severance) during any period of service in the uniformed services. A plan is not required to allow distribution upon deemed severance of an individual. However, if a plan allows distributions on deemed severance and an individual elects to receive a distribution from the plan, the individual may not make an elective deferral (includes any deferrals made to an eligible

governmental plan under IRC section 457(b)) or employee contribution during the 6-month period beginning on the date of the distribution.

- If a plan provides for (1) qualified reservist distributions and (2) distributions on deemed severance, and a distribution to an individual could be either type of distribution, the distribution is treated as a qualified reservist distribution and the 6-month restriction on elective deferrals and the 10% additional income tax for early distributions do not apply.
- In determining the limitation on contributions to an IRA, compensation includes differential wage payments.

Section 107 – Distributions from Retirement Plans to Individuals Called to Active Duty

The Pension Protection Act of 2006 included special rules that applied to qualified reservist distributions for individuals ordered or called to active duty after September 11, 2001 and before December 31, 2007. Section 107 of the HEART Act removed the reference to December 31, 2007, so that such special rules no longer have an expiration date.

The special rules retained by Section 107 are:

- Qualified reservist distributions of amounts attributable to elective deferrals are not subject to the 10% additional income tax for early distributions; and
- During the two-year period beginning on the day after the end of the individual's active duty service, the individual who receives a qualified reservist distribution may contribute to a nondeductible IRA an amount up to the amount of the distribution. The amount contributed will not count toward the IRA contribution limit.

Effective Dates and Amendments to Comply with Sections 104, 105 and 107

- Section 104 applies to deaths and disabilities occurring on and after January 1, 2007. The section 105(b) changes apply to years beginning after December 31, 2008. The change made by section 107 applies to individuals ordered or called to active duty on or after December 31, 2007.

A plan is treated as being operated in accordance with the changes made by sections 104, 105 and 107 if the plan is amended by the last day of the first plan year beginning on or after January 1, 2010 (December 31, 2010 for calendar year plans). Governmental plans have until 2012 to comply with the amendment requirement.

Section 109 – Contributions of Military Death Gratuities to Roth IRAs and Coverdell Education Savings Accounts (Coverdell ESAs)

- Section 109 of the HEART Act amended the rule relating to a qualified rollover contribution to a Roth IRA to include a contribution of a military death gratuity or a payment made to a beneficiary of a deceased member of the uniformed services during the one-year period starting on the date such beneficiary received payment under the Servicemembers' Group Life Insurance (SGLI) program. Such contribution does not count against the annual contribution limit on Roth IRAs and the phase-out rule based on income does not apply.

Similar amendments were made to a Coverdell ESA to treat the contribution of a military death gratuity or SGLI payment as a rollover contribution and the annual limit and phase-out of the annual limit based on income do not apply to the contribution.

- Notice 2010-15 provides that the amount treated as a qualified rollover contribution to a Roth IRA cannot exceed the total amount of the military death gratuity and SGLI payments received, reduced by any portion of such amount contributed to another Roth IRA or a Coverdell ESA. Similar rules apply in determining the amount treated as a rollover contribution to a Coverdell ESA.

The Notice further provides that the amount treated as a qualified rollover contribution to a Roth IRA or a rollover contribution to a Coverdell ESA is treated as investments in the contract (basis).

Effective Date of Section 109 and Special Rule

- The changes made by section 109 generally apply to deaths from injuries occurring on or after June 17, 2008.

A special rule applies to deaths from injuries occurring between October 7, 2001 and June 17, 2008. Section 109 permits a contribution to a Roth IRA or a Coverdell ESA of a military death gratuity or an SGLI payment with respect to such deaths provided the contribution is made no later than June 17, 2009.

Section 111 – Employer Credits for Differential Wage Payments to Employees Who Are Active Duty Members of the Uniformed Services

Section 111 of the HEART Act adds section 45P to the IRC. IRC section 45P provides a small business employer a credit against its income tax liability if it makes differential wage payments to “qualified employees” who are on active duty in the uniformed services for more than 30 days. The amount of the credit is 20% of the sum of the eligible differential wage payments made to qualified employees during the taxable year of the small business employer.

- A qualified employee is an employee who is employed by a small business employer for the 91-day period immediately before the period for which differential payments are made.
- A small business employer is an employer that employed an average of fewer than 50 employees on business days during the taxable year and provides differential wage payments under a written plan to every qualified employee. The rules of IRC sections 414(b), (c), (m) and (o) apply in determining if an employer qualifies as a small business employer.
- For purposes of IRC section 45P, an eligible differential wage payment has the same meaning as in section 105, above.
- The maximum amount of differential wage payments that may be included in calculating the credit is \$20,000 (\$4,000 credit) per qualified employee per taxable year.
- The IRC section 45P credit is to be coordinated with other credits under Chapter 1 of the IRC, in the following circumstances:
 - The amount of another credit under Chapter 1 of the IRC must be reduced by the amount of the IRC section 45P credit for an employee if:
 - compensation in the current taxable year is used directly in determining the amount of the other credit;
 - military differential wage payments are taken into account as compensation in determining the amount of the other credit; and
 - military differential wage payments are taken into account in determining the IRC 45P credit and the other credit.

Comments Requested

Written comments regarding items to be included in future guidance must be submitted to the IRS by April 9, 2010 to the following address:

CC:PA:LPD:DRU (Notice 2010-15)
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