

IRS Issues Guidance Under HEART Act

The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") included a variety of benefit enhancements under qualified retirement plans for employees on leave in active military service. A number of the new requirements were effective beginning in 2009, but the legislative language left many questions regarding implementation.

In the first published guidance under the HEART Act, IRS Notice 2010-15 provides selected answers, a few of which are a bit surprising. Here are some of the highlights.

- A qualified retirement plan that provides special death benefits for participants who die in active employment (including, e.g., full and immediate vesting) must provide those same benefits to survivors of participants who die in active military service with rights to reemployment by the plan sponsor. Specifically, the plan is required to treat such military personnel as if they had resumed employment and then terminated employment on account of death. The IRS has clarified that this means participants who die in military service must receive service credit for vesting for the period of military service, because they would have received such credit if they had been reemployed while their rights to reemployment were protected by law. The plan is not required to provide the same credit for military service for benefit accrual purposes, nor is it required to treat participants who become disabled during military service in the same manner as participants who become disabled during active employment - although in either case the plan is permitted to do so.
- Differential wage payments to individuals on active duty for more than 30 days must be treated as wages and reported on Form W-2. Qualified retirement plans, 403(b) plans and 457(b) plans are also required to treat such individuals as employees and to treat differential wage payments to them as compensation. The IRS has clarified that the requirement to treat differential wage payments as compensation applies only for purposes of Internal Revenue Code requirements, such as section 415 limits on contributions and benefits. Differential wage payments need not be treated as plan compensation for purposes of determining contributions and benefits under the plan. Individuals receiving differential wage payments need not also receive contributions or benefit accruals under the plan based on those differential wage payments.
- For purposes of restrictions on distribution of pre-tax participant deferrals under 401(k), 403(b) or 457(b) plans, an individual must be treated as severed from employment during any period of active duty for more than 30 days. Under the legislative language, it was unclear whether this treatment only applied to individuals who also received differential wage payments. The IRS has clarified that this treatment applies to all individuals on active duty for more than 30 days, whether or not they receive differential wage payments.
- Notwithstanding the treatment of individuals on active duty for more than 30 days as severed from employment for purposes of Code restrictions on distribution of pre-tax deferrals, a plan that otherwise permits distribution of pre-tax deferrals upon severance from employment is not required also to permit distribution of pre-tax deferrals on the "deemed" severance from employment of such individuals. In other words, a 401(k) plan need not permit distribution of pre-tax deferrals to an individual on active duty if that individual is otherwise treated by the employer as still employed.
- An individual on active duty for more than 30 days is not, for that reason alone, treated as severed from employment for purposes of eligibility for distributions from a defined benefit pension plan. Treatment as severed from employment is only for purposes of restrictions on distribution of pre-tax deferrals.
- If a 401(k), 403(b) or 457(b) plan so permits, an individual on active duty for more than 30 days may receive a distribution of pre-tax deferrals, but he or she is suspended from making additional contributions to the plan (e.g., from differential wage payments or upon reemployment) for 6 months thereafter. A separate provision of

the Code also permits distribution of pre-tax deferrals, without any 10% early distribution tax, to a military reservist on active duty for a period of more than 179 days or for an indefinite period. This is called a "qualified reservist distribution." The IRS has clarified that a distribution of pre-tax deferrals to a military reservist who meets the requirements for both kinds of distributions will be treated as a qualified reservist distribution and will not subject the recipient to a 6-month suspension of contributions.

If you have questions or would like additional information about benefits under the HEART Act, please feel free to contact Brian Dougherty at 215-587-5919 or bdougherty@postschell.com.

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