

**OAKLAND COUNTY BAR ASSOCIATION  
EMPLOYEE BENEFITS COMMITTEE PRESENTATION**

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**MARCH 9, 2008**

A variety of military-related statutes impact employer sponsored employee benefit plans. Rather than discuss the rules in great detail, this outline provides the origin of various rules and briefly explains them.

**I. Servicemembers Civil Relief Act of 2003 (“SCRA”) - 50 USC Appendix 501 through 596**

The SCRA updates and clarifies the Soldiers' and Sailors' Civil Relief Act of 1940 which is referred to in an example in the IRS/Treasury loan regulations. See Treasury Regulation 1.72(p)-1 Q&A-9(d) Example #2.

The SCRA retains the provision (from the Soldiers' and Sailors' Civil Relief Act) that prevents a creditor (such as a retirement plan) from charging more than 6% interest on any loan outstanding at the time the participant begins military service. However, to qualify for an interest rate reduction, the SCRA now requires that the participant give the plan sponsor written notice and a copy of the military orders calling the participant to military service, including any orders extending military service. If the participant provides this information within 180 days after military service ends, the reduced rate of 6% applies as of the date the participant was called to military service and ends on the date the participant is either released from military service or dies while in military service. Accordingly, the reduced rate must be applied retroactively if the participant provides the notice after military service begins. Once the participant provides the proper notice, the plan sponsor must reduce the interest rate unless there is a court order allowing retention of the higher rate. If the original interest rate on the loan was 6% or less, no change in the interest rate is required.

Only loans taken before the participant enters military service are subject to the 6% maximum interest rate under the SCRA. If a participant takes a new loan while on

military leave, the new loan accrues interest at the plan's normal rate for that loan type even if that rate is greater than 6%.

The Housing and Economic Recovery Act of 2008 amended the SCRA to extend the period of the 6% cap on mortgages to the period of military service plus one year thereafter. However, this extension does not appear to apply to plan loans. The Veterans' Benefits Improvement Act of 2008 amends the SCRA to provide a criminal penalty for knowing violations of the interest rate limit.

Although not related to the SCRA, it is worth noting that under IRS/Treasury loan regulations, the participant must resume loan repayments when the military service ends with the payment frequency and amount at least equal to the pre-military schedule. The rehired veteran must repay the full loan amount (including interest accrued during the military service period) by the end of the maximum term for the original loan plus the military service period. See Treasury Regulation 1-72(p)-1 Q&A-9(b).

## II. Heroes Earnings Assistance and Relief Tax Act of 2008 (Heroes Act or HEART Act) – Signed / Enacted June 17, 2008.

### A. Retirement Plans subject to Internal Revenue Code Sections 401(a), 403(b) and 457(b)

#### 1. Survivor and Disability Payments

##### (a) Mandatory Ancillary Benefits: New IRC 401(a)(37)

Plans **must** treat a participant who dies while on active duty as if he or she had been re-employed on the day before death. A participant's survivors are entitled to any additional benefits (excluding benefit accruals related to the period of military service) that would have been provided under the plan had the participant resumed employment and then terminated on account of death. The benefits would include accelerated vesting, ancillary life insurance, or any other benefits the plan would have otherwise provided to participants who die while actively employed.

The requirement applies for participant deaths occurring on or after January 1, 2007. The plan amendment deadline is the last day of the first

plan year beginning on or after January 1, 2010 (January 1, 2012 for governmental plans).

(b) Optional Benefit Accruals: New IRC 414 (u)(9)

For the purpose of benefit accruals, plan sponsors *may* treat an individual who dies or becomes disabled while performing military service as having resumed employment on the day prior to death or disability, and then terminating employment as a result of the death or disability. This provision, if adopted, must be made available to employees on reasonably equivalent terms. Compensation is calculated in accordance with deemed compensation under USERRA (see below), and the amount of employee contributions and deferrals is based on the individual's average actual contributions or deferrals for the 12-month period of service immediately preceding military service, or the actual length of service, if less than 12 months. In essence, a plan counts the "rehired" veteran's uniformed service for vesting and benefit accrual and the employer fulfills any corresponding funding obligation for the military service period in question.

A plan may adopt this provision for deaths or disabilities occurring on any date after January 1, 2007. The plan amendment deadline is the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012 for governmental plans).

2. Differential Payments: New IRC 3401(h) and New IRC 414(u)(12)

A differential wage payment is any payment by an employer to an employee who is called to active duty for more than 30 days which payment represents the difference between the compensation he or she would have received from the employer but for the active military duty and the compensation received for military duty. These differential wage payments are voluntary payments made by the employer. HEART makes significant changes as to how differential wage payments (if made) are treated:

- Previously, differential payments were generally not treated as “wages” for federal withholding purposes. As a result service members instead received an IRS Form 1099 and were obligated to pay self-employment taxes on differential pay.
- HEART allows differential wage payments to be treated as IRS Form W-2 wages for purposes of income tax withholding with respect to amounts paid after December 31, 2008. In order to be treated as Form W-2 wages: (1) the differential pay must be paid by an employer to an individual with respect to any period during which the individual is performing active duty military service for a period of more than 30 days; and (2) the payments represent all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer.
- HEART allows differential wage payments to be treated as plan eligible compensation, so that the plan may permit such individuals to make contributions to the retirement plan on the basis of this compensation. To the extent that any contributions or benefits are based on differential wage payments, participants must be entitled to receive the payments and to made contributions from the payments on reasonably equivalent terms.
- Although differential wage payments are plan eligible compensation and applicable individuals may make contributions to the plan based on this compensation, individuals are treated as severed from employment for the purposes of the limitations that would otherwise restrict the withdrawal of pre-tax deferrals. Accordingly, a distribution of elective deferrals is permitted, but the individual's right to make future elective deferrals or employee contributions under the plan will be suspended for six months beginning on the date of the distribution.

The effective date is plan years beginning after December 31, 2008. The plan amendment deadline is the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012 for governmental plans).

3. Amends IRC 72(t)(G) exemption to 10% early withdrawal penalty tax for IRC Section 401(k) and 403(b) plans.

The waiver of the premature withdrawal penalty that was established under the Pension Protection Act of 2006 for certain reservists called to active duty and taking distributions from a retirement plan is made permanent. Under this provision, for reservists called or ordered to duty for more than 179 days or for an indefinite period, distributions of the reservist's elective deferrals are not subject to the 10% early withdrawal penalty, and these amounts may be re-contributed to an IRA on an after-tax basis during the 2-year period after active duty ends. Under the Pension Protection Act this provision was scheduled to expire after December 31, 2007, but it is made permanent by the HEART Act. The extension is immediately effective.

B. Health Flexible Spending Arrangements / Cafeteria Plan New IRC 125(h)

Effective June 17, 2008, HEART adds an **optional** exception to the general "use it or lose it" rule that applies to cafeteria plans offering health care flexible spending arrangements ("health FSA"). Effective for distributions made after June 17, 2008 (the date of enactment of the HEART Act), a health FSA or cafeteria plan will not lose its tax favored status if it permits a "qualified reservist distribution." A qualified reservist distribution for these purposes is a distribution to a participant in a health FSA of all or a portion of the participant's health FSA balance if:

- (1) the participant is a reservist called to active duty for a period of at least 180 days (or is called for an indefinite period); and
- (2) the distribution is made during the period beginning with the call to active duty and ending on the last day of the coverage period of the health FSA that includes the date of the call to active duty.

IRS Notice 2008-82 provides further guidance.

### III. Family and Medical Leave Act - 29 USC §2601, et. seq.

The Family and Medical Leave Act ("FMLA") was amended on January 28, 2008 pursuant to Section 585 of the National Defense Authorization Act for Fiscal Year 2008:

- Leave to Care for Injured Service Members: This new provision allows eligible employees who are the spouses, children, parents, or next of kin of a service member to take one leave of up to 26 weeks under the FMLA to care for a service member who incurred an injury during military service. Regulations issued by the U.S. Department of Labor ("DOL") are effective January 16, 2009, and are located at 29 CFR Part 829. Among other things, the regulations provide guidance on when this leave is available and who may take leave. The regulations indicate that the DOL has interpreted the statutory provisions more broadly than many employers may have anticipated:
  - First, the term "next of kin," is broadly defined to include grandparents, aunts, uncles, first cousins, and any relative so designated by the service member – not just spouses, parents, and children.
  - Second, although the military caregiver leave can be taken only once per injury, more than one family member may qualify for it.
  - In addition, although the statute refers to a "one time" leave of up to 26 weeks, the FMLA final rules provide that military caregivers may take leave again if the service member incurs other injuries. The leave, however, is available only while the service member remains in the military.
- Leave for Qualifying Exigencies: This amendment allows families of certain military personnel to take FMLA leave for "qualifying exigencies." The new FMLA rules define who is eligible for this type of leave and the very specific circumstances under which it is available.

- o Significantly, this leave is only available to the covered family member of National Guard and Reserve personnel on active duty. This leave is not available to family members of active duty members of the Armed Forces.
- o The rules define the "specific" and "exclusive" list of "qualifying exigencies" as: (1) short-notice deployment (2) military events and related activities (3) childcare and school activities (4) financial and legal arrangements (5) counseling (6) rest and recuperation (7) post-deployment activities and (8) additional activities where the employer and employee agree to the leave.

Every employer covered by the FMLA is required to post a notice (provided by the U.S. Department of Labor) explaining employee rights and responsibilities under the FMLA – including the above described family military leave rights. If an employer has even one employee eligible for FMLA leave, in addition to posting the notice, the employer must provide each employee with general notice information (including at least all of the information contained in the poster); this individual notice can be contained in employee handbooks.

#### **IV. John Warner National Defense Authorization Act for Fiscal Year 2007 (Public Law 109-364).**

Effective January 1, 2008, group health plan sponsors can no longer offer employees eligible for TRICARE (the military health program) a financial incentive not to enroll in the plan if the plan would have been primary to TRICARE.

Specifically, the law prohibits an employer or other entity from offering any financial or other incentive to a TRICARE-eligible employee not to enroll (or to terminate enrollment) under a group health plan that would be primary to the TRICARE plan. Violating this rule would subject the employer or plan sponsor to civil monetary penalties of up to \$5,000 for each violation.

In addition, a TRICARE-eligible employee must be given the opportunity to elect to participate in an employer-sponsored group health plan and to have primary coverage under that employer plan in the same manner and to the same extent as similarly situated non-TRICARE eligible employees. Consequently, a plan sponsor

cannot mandate that a TRICARE-eligible employee not enroll in, or drop coverage under, the employer's group health plan in favor of TRICARE coverage. Whatever choice the individual makes, it will not affect his or her eligibility for TRICARE coverage.

The law applies to employers with 20 or more employees, including state and local government plans, and group health plans. Both insured and self-insured employer-sponsored plans as defined in Section 5000(b)(1) of the Internal Revenue Code are considered group health plans and subject to the law. TRICARE-eligible employees include any beneficiary receiving benefits under TRICARE, not just the member of the armed services.

**V. Heroes Earned Retirement Opportunities Act**

Effective with the 2004 tax year, compensation earned for service in a combat zone by members of the armed forces is taken into account for purposes of the annual IRA and Roth IRA contribution limitation.

Before the legislation, the annual limitation for traditional IRA and Roth IRA contributions – in general, the lesser of a specified dollar amount or 100% of *taxable* compensation – created an inequitable result for members of the armed forces receiving combat pay. Because combat pay is excluded from gross income by Internal Revenue Code section 112, individuals whose compensation consisted exclusively of combat pay had an IRA contribution limit of zero.

**VI. Veterans Benefits Improvement Act of 2004 and Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) - Title 38, USC, Chapter 43.**

The Veterans Benefits Improvement Act requires employers to post a notice informing employees of their rights under USERRA. It also increases health care continuation coverage under USERRA for employees on military leave from 18 months to 24 months.

A. Health benefits under USERRA.

Generally speaking, USERRA (as amended by the Veteran Benefits Improvement Act) provides individuals who leave their civilian jobs to perform military service with the right to elect to continue their existing employment-based health care coverage during their military service for a period of up to 24 months (or less, if the service member fails to return from service or timely apply for reemployment). In addition, USERRA requires that upon a service member's reemployment with his or her employer, the service member's and his or her eligible dependents' coverage under the employer's group health plan must be reinstated (at the service member's election) without a waiting period or exclusion that would not have been imposed had coverage not been suspended or terminated due to military service.

Unlike COBRA, the health care continuation rights under USERRA are available to a service member regardless of the size of his or her employer's workforce.

In December 2005, the U.S. Department of Labor ("DOL") issued final regulations pursuant to USERRA. The portion of the rules relating to the payment of premiums during USERRA continuation coverage are similar to COBRA in that plans are permitted to charge covered individuals up to 102% of the full coverage premium (*i.e.*, both the employer and employee share of the premium). Under USERRA, however, if a service member is on military duty for less than 31 days, he or she cannot be required to pay more than the employee share, if any, of the premium for health care coverage.

The preamble to the final regulations clarifies that dependents do not have any independent right to elect USERRA health plan continuation, and dependents or retirees who perform military service do not have any rights to continue health plans coverage under USERRA.

The preamble clarifies that USERRA also applies to cafeteria plans. The result of this clarification is that employees who have their pay continued by the employer while on leave can purchase health plan coverage on a pretax basis, and they can also elect to continue their health care flexible spending arrangement. Further, cafeteria plan change-in-status rules will not be violated if a plan offers a new health plan or spending account election upon an employee's leaving for, or returning from, military service.

B. Retirement plan issues under USERRA and final regulations

1. Funding retirement plan benefit

- For defined contribution plans, with regard to employer nonelective contributions, once the employee is reemployed, the employer must make a contribution for the period of uniformed service. With regard to elective deferrals or after-tax contributions, re-employed participants will have the right to make-up deferrals or after-tax voluntary contributions.
- For defined benefit plans, the employee's accrued benefit will be increased for the period of service once he or she is reemployed and, if applicable, has repaid any amounts previously paid to him or her from the plan and made any employee contributions that may be required to be made under the plan.

2. Deadline for employer to make contribution

• Non-contributory plans

For a plan in which the employee is not required or permitted to contribute, the employer must make the contribution attributable to the employee's period of uniformed service no later than:

- 90 days after the date of reemployment or
- when plan contributions are normally due for the year in which the service in the uniformed services was performed, whichever is later.

If it is impossible or unreasonable for the employer to make the contribution within this time period, the employer is permitted to make the contribution as soon as practicable.

- Contributory plans. The employee is allowed (but not required) to make-up his or her missed after-tax contributions or elective deferrals.

- The make-up time period starts with the date of reemployment and continues for up to three times the length of the employee's immediate past period of uniformed service, not to exceed five years.
- The employee's make-up time period ends at the *earlier* of
  - the employee's termination of service, or
  - the end of the make-up time period.

Thus, the employee's make-up period ends when service is terminated. However, if the employee is rehired again then the remainder of the make-up time would become available to the rehired employee.

- Employer match or contingent contribution

The employee must make-up the contributions or elective deferrals in order to receive the employer match on the accrued benefit attributable to his or her contribution. The deadline for the employer contribution of the match is based on when the make-up contributions are made.

- Any employer contributions that are contingent on or attributable to the employee's make-up contributions or elective deferrals must be made according to the plan's requirements for employer matching contributions.

### 3. Defined benefit plan distributions may be repaid upon reemployment

- An employee who received a distribution of all or part of his or her accrued benefit from a defined benefit plan in connection with leaving employment for duty in the uniformed services must be allowed to repay the withdrawn amounts when reemployed.
- The employee must repay the amount of the defined benefit that would have accrued had the monies not been withdrawn with interest included.

- The repayment time period starts upon reemployment and continues for up to three times the length of the employee's immediate past period of uniformed service, with the repayment period not to exceed five years (or such longer time as may be agreed to between the employer and the employee). If the employee leaves employment before the end of the make-up period, the make-up period would end at that time.
4. Determining compensation for the period of service in order to determine the employee's pension benefits, if benefits are based on compensation: The calculation must be made using the rate of pay that the employee would have received but for the period of uniformed service.
- If the employee had 12 months or more of service before the period of uniformed service, and the rate of pay the employee would have received is not reasonably certain, such as where compensation is based on commissions earned, the average rate of compensation during the 12-month period prior to the period of uniformed service must be used.
  - If the employee had less than 12 months of service before the period of uniformed service, and the rate of pay the employee would have received is not reasonably certain, the average rate of compensation must be derived from this shorter period of employment that preceded service.