

Regulatory Update

USERRA and the HEART Act

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As members of the military continue to leave and reenter the workforce, employers should be aware of the legal requirements imposed by the Uniformed Services Employment and Reemployment Rights Act (USERRA) and the Heroes Earnings Assistance and Relief Tax Act of 2008 (the HEART Act). These laws grant a number of benefit rights to employees on or returning from military leave. Certain provisions directly affect employee benefit plans sponsored by the employer, which are highlighted here.

USERRA

Defining “Uniformed Services”

USERRA, signed into law on October 13, 1994, applies to individuals who perform duty in the “uniformed services,” which include the Army, Navy, Marine Corps, Air Force, Coast Guard, and Public Health Service commissioned corps, as well as the reserve components of each of these services. Federal training or service in the Army National Guard and Air National Guard also gives rise to rights under USERRA. In addition, under the Public Health Security and Bioterrorism Response Act of 2002, certain disaster response work is considered performance in the “uniformed services.” USERRA applies to virtually all public and private U.S. employers, regardless of size. USERRA primarily grants re-employment rights to employees that are absent from work due to military service.

Plans That Are Affected by USERRA

USERRA provides certain protections for members of the military who are participants in an employee pension benefit plan, which is defined to include any plan that provides retirement income to employees until the termination of employment or later. According to the non-technical resource guide issued by the Department of Labor Veterans’ Employment and Training Services, a pension plan includes defined benefit plans, defined contribution plans, and profit sharing plans that are retirement plans. USERRA also covers certain pension plans not covered by the Employee Retirement Income Security Act of 1974 (ERISA), such as those sponsored by a state, government entity, or church. However, USERRA does not apply to pension benefits under a Federal Thrift Savings Plan.

USERRA also impacts certain health benefit plans of retiring members of the military. As well, USERRA allows for continuation of coverage during qualifying military leave.

Vesting and Benefit Accrual While on Active Military Duty

Under USERRA, employees participating in an employee pension benefit plan are not treated as having a break-in-service while on active military duty. Military service must be considered service with an employer for vesting and benefit accrual purposes. With respect to a defined contribution plan, the employee must be allowed to make up any missed deferral contributions attributable to his or her service and the employer must make up any employer contributions the employee would have been entitled to during the service period. With respect to a defined benefit plan, the employee's accrued benefit must be increased by the time the employee was in service to the extent that he or she repays any amounts distributed during the period of service. Of course, the employee must return to active employment to receive these USERRA retirement plan benefits.

Welfare Plan Impact of USERRA Upon Re-employment

USERRA mandates that employers provide certain COBRA-like coverage during a period of service. The maximum time period is 24 months for such coverage. When an employee returns from active service, USERRA generally provides that such employee must be reinstated to his or her previous coverage and coverage levels. (There is an exception with respect to service-related disabilities.) As well upon return from this absence, if the Section 125 plan allows for return from an unpaid leave to be a change in status event, return from service should permit such a benefit election change provided the other elements of a status change are met.

HEART Act

Qualified Survivor Benefits

The HEART Act, passed into law on June 17, 2008, applies to qualified retirement plans, 403(b) plans, and 457(b) plans. If a participant dies while performing in the uniformed services, the survivors are entitled to receive any additional benefits (other than benefit accruals relating to the period while on military leave) provided under the plan as if the participant had resumed employment on the day before death. This requirement applies to deaths occurring on or after January 1, 2007. Plans must be amended to comply with this requirement by the end of the first plan year that begins on or after January 1, 2010. Government plans must comply with these rules by adopting an amendment by the end of the first plan year that begins on or after January 1, 2012.

Benefit Accrual

As stated above, USERRA requires plans to credit service for employees who return to work from military service. The HEART ACT allows, but does not require, plans to provide benefit accrual for participants who do not return to work due to death or disability on account of their military service. If an employer elects to adopt this provision, the participant is treated as if he or she resumed employment on the day before death or disability. Individuals who die or become disabled must be credited with service and benefits on reasonably equivalent terms. If adopted, plans must be amended for this requirement by the end of the first plan year that begins on or after January 1,

2010. If a government plan adopts this provision, it must do so by the end of the first plan year that begins on or after January 1, 2012.

Distributions from Retirement Plans to Individuals Called to Active Duty

Under the Pension Protection Act of 2006, employees reporting for active duty were permitted to make distributions from a 401(k) plan, 403(b) plan, 457(b) plan, or an IRA without paying a penalty on early withdrawals. The HEART Amendment makes this exemption permanent for employees called into duty after September 11, 2001. Any such individual must be called into active duty for a period in excess of 179 days or an indefinite period.

Contributions of Military Death Gratuities to Roth IRAs and Educational Savings Accounts

If the survivors of a member of the military receive a military death gratuity, this amount may be rolled over to a Roth IRA or Education Savings Account on a tax-free basis. Any rollover must occur within one year of receiving the payment. This rule applies to payments made in connection with deaths that occurred on or after June 17, 2008.

Differential Wage Treatment

Employees who are called into active duty often lose income due to the difference between wages they could have received from their employer and the wages earned in the military. Employers may choose to supplement any lost income by making differential wage payments. Prior to the passage of the HEART Act, differential pay was not deemed “wages” for purposes of withholding income and employment taxes. After December 31, 2008, all differential wage payments are treated as wages for federal tax withholding purposes. Moreover, differential wage payments are included in the definition of compensation under a retirement plan. As a result, an employee may choose to make deferrals based on any differential wages he or she receives. In addition, employers with fewer than 50 employees that elect to make differential wage payments may receive a 20 percent tax credit on up to \$20,000 of differential wage payments made to each qualified employee.

Special Rules for Unused Benefits in Health Flexible Spending Arrangements

An employer may amend a Section 125 plan (a cafeteria plan) to permit a distribution of any unused amount from a member of the military’s health flexible spending account (FSA) if the participant is called to active duty for a period in excess of 179 days or for an indefinite period. Any distribution must be made between the day the participant is called into active duty and the last day of the plan year.

Action Items

Plans must be amended to reflect the changes under these laws. Under USERRA, employers should develop procedures for calculating benefit accruals and vesting for members of the military who fail to return to work as a result of military service. As stated above, the HEART Act provision granting survivor benefits for those lost while on military leave is retroactive for deaths occurring on or after January 1, 2007. Employers must develop procedures to review whether any participants may be affected by this rule, and determine the necessary benefits accordingly. Plans that intend to adopt the optional provision regarding benefit accrual due to death or disability while on military leave

must do so by the last day of the plan year that begins on or after January 1, 2010 (January 1, 2012, for government plans). Employers that elect to make differential wage payments must implement procedures designed to ensure that these payments will be reported properly on a Form W-2. Finally, employers may choose to amend their health FSA plans to allow employees to receive a distribution from their unused account balances while the employee is on active military duty.

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