



AMERICAN BENEFITS COUNCIL

September 4, 2008

W. Thomas Reeder
Benefits Tax Counsel
Treasury Department
1500 Pennsylvania Ave., NW
Room 3054
Washington, D.C. 20220

Re: Request for Guidance on Benefits Provisions of the HEART Act

Dear Mr. Reeder:

I am writing on behalf of the American Benefits Council (the "Council") to request guidance on a variety of issues that have arisen under the employee benefits provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (the "HEART Act"), which was signed into law on June 17, 2008. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Council's members have raised a number of questions about sections 104, 105 and 107 of the HEART Act, which generally provide relief from certain retirement plan rules for distributions, contributions and accruals made on behalf of participants engaged in qualified military service. As discussed below, there are numerous technical questions under these sections for which guidance would be appropriate and helpful. We greatly appreciate that the Treasury Department and Internal Revenue Service (collectively, the "Service") have a number of very important ongoing guidance projects; however, there is some urgency to the HEART Act issues given that some of the benefits provisions of the HEART Act are already effective and others will be effective for years beginning after December 31, 2008. Some of these changes will also involve changes to payroll processing, which can involve significant programming efforts that take time to implement. Below we identify a number of the issues that our members have raised and suggest possible resolutions.

Survivor and Disability Payments With Respect to Qualified Military Service

Section 104(a) of the HEART Act provides that all tax-qualified plans, 403(b) plans and governmental 457 plans must provide that survivors of a participant who dies while performing qualified military service are entitled to any additional benefits (other than benefit accruals) that would have been provided if the participant had resumed employment and died while employed. As a result, for example, it appears that vesting is required with respect to amounts subject to a vesting schedule that includes accelerated vesting upon death. Similarly, death benefits payable under a defined benefit plan would be payable to the survivor of a participant who dies while performing qualified military service.

One question that has arisen is whether the distinction drawn in section 104(a) between death benefits and benefit accruals is clear in every instance. It is not uncommon, for example, for a defined benefit plan to provide that all or some of a participant's accrued benefit is payable to the participant's beneficiary upon death. This is a death benefit in the sense that a defined benefit plan is not obligated to pay any portion of a participant's accrued benefit to a participant's survivor.¹ Such a reading, however, would appear to be inconsistent with the provision in section 104(a) that provides an exception for benefit accruals. For this reason, we believe that plans are not obligated to pay death benefits to survivors to the extent that the death benefit is attributable to a benefit accrual that would otherwise have accrued during the period of qualified military service, and it would be helpful if this point were clarified.

Another question that has been raised is whether death benefits might be required for a former employee who dies during qualified military service with respect to a subsequent employer if the employee has not yet incurred a five-year break-in-service with the first employer. Section 104(a) refers to qualified military services as defined in section 414(u) of the Internal Revenue Code ("Code"), which in turn refers to USERRA reemployment rights. These rights would not ordinarily attach to a former employee who subsequently has military service. For these reasons, it appears death benefits would not be required because the military service would not be "qualified military service." However, a clarification would be helpful.

Unlike section 104(a) which requires plans to provide death benefits, section 104(b) of the HEART Act allows employers to treat an employee who dies in military service as if he or she died while employed for benefit accrual purposes. Several questions have been raised with respect to this provision. First, since this is a permissive provision, it appears that a plan could adopt a provision implementing section 104(b) on a prospective basis as of any date. Alternatively, a plan may choose to implement the provision on a retroactive basis, provided that such retroactive date is no

¹ This is true of a qualified preretirement survivor annuity which, although required, is not part of the participant's accrued benefit although it is derived from the accrued benefit.

earlier than January 1, 2007, which is the effective date of section 104. However, clarification on this point would be welcome.

Second, section 104(b) allows a plan to provide benefit accruals for the period in which a participant who dies or becomes disabled was in qualified military service. The section does not, however, explicitly address vesting credit (if such credit was not required under section 104(a)). We believe that employers should have the flexibility to decide whether to provide vesting service credit. In addition, to the extent such credit is provided, it should be eligible for relief from the nondiscrimination requirements to the same extent that relief is provided for benefit accruals. We suggest guidance confirming this point.

Treatment of Differential Pay for Retirement Plan Purposes

Section 105(b) of the HEART Act generally provides that plans must count differential pay as compensation for retirement plan purposes and that a plan shall not be treated as failing to satisfy certain provisions if contributions or accruals are provided based on differential pay.

A basic question is whether employers that provide differential pay are obligated under section 105(b) to provide individuals receiving differential pay with the right to make elective deferrals, receive matching contributions and have nonelective contributions made on their behalf. The statute is not particularly clear on this point. It would, however, be anomalous for the law to obligate employers to provide contribution rights on differential pay since there is no general obligation to provide differential pay at all. Instead, it makes more sense to construe section 105(b) as eliminating barriers to providing contributions based on differential pay, for example, by deeming differential pay to be compensation for purposes of sections 401(k) and 415 of the Code, and not mandating such contributions.

Some members have also pointed out that taking differential pay into account as plan compensation could have the effect of reducing the benefits of some participants in final average pay plans. This may occur because part of their final average earnings would be based only on the amount paid by their employer, which would almost invariably be lower than their normal compensation because of the offset for military pay or because the differential pay is not based on 100 percent of their normal compensation. It appears to be possible to design a plan to avoid this consequence, which does not seem intended. However, we are concerned that this provision could create a trap for the unwary to the detriment of individuals performing qualified military service, particularly participants who die or become disabled while performing qualified military service. For this reason, we recommend guidance clarifying that differential pay received by a participant in an average pay plan need not be taken into account to the extent that it would have the effect of reducing that participant's accrued benefit.

Another set of questions is raised by the portion of section 105(b) which provides that an individual in military service will be treated as severed from employment for purposes of the ability to receive a distribution of elective deferrals, but imposes a six-month contribution suspension requirement for such distributions. A threshold question is whether this relief from the prohibition against in-service distributions is limited to participants that are receiving differential pay. We believe that it is not so limited. Section 105(b)(1)(B) applies to individuals who are performing services in the uniformed services described in Code section 3401(h)(2)(A), which applies broadly to an individual who is performing service in the uniformed services while on active duty for a period of more than 30 days.²

Section 105(b) of the HEART Act is closely related to Code section 401(k)(2)(B)(i)(V), which permits in-service withdrawals by qualified reservists. However, there are a number of differences between the two provisions. For example, a distribution described in the HEART Act is subject to a 6-month suspension of elective deferrals while a distribution under Code section 401(k)(2)(B)(i)(V) is not subject to any suspension rules. Similarly, the Code provision is only available to an individual who was ordered or called to active duty for a period in excess of 179 days or for an indefinite period, while the HEART Act provision applies to an individual who is on active duty for a period of more than 30 days. We strongly recommend guidance clarifying the interaction of these two provisions.

We have also had members raise questions about whether a distribution under the HEART Act would be considered rollover eligible (and subject to the mandatory 20% withholding rules) or treated like a hardship distribution (since deferrals must be suspended for six months). We believe that guidance would be helpful on this point and that relief should be provided to the extent a plan (or service provider) has construed the rule in a reasonable manner that differs from the interpretation in published guidance.

Other questions focus on the language defining military differential pay. Section 105 references pay being made with respect to any period during which the individual is performing services while on active duty for a period of more than 30 days. The issue is whether the pay becomes subject to section 105 only after the 30th day, or from the first day so long as the individual is expected to be on active duty for more than 30 days. The latter approach is preferred and would be far easier to administer. Any other approach would impose a level of administrative complexity that would be likely to lead to confusion and unintended operational defects.

² If the Service were to take a contrary position, a number of issues would need to be resolved, including, for example, whether the distribution right is limited to participants who are electing to defer differential pay or to participants who are eligible to so defer such pay.

Another common question involves the status of amounts eligible for the in-service distribution rights. A basic question is whether the distribution provision covers both elective deferrals and earnings, which we assume it does. A related question is whether it is possible to permit in-service distributions in connection with military service described in section 105(b) of the HEART Act for all sources, including non-elective contributions as well as elective deferrals. It appears that amounts attributable to non-elective contributions to a profit sharing plan may also be distributed in connection with qualified military service because such service would be the occurrence of a stated event. This would, however, not be the case for money purchase pension plans, which are subject to more restrictive rules. It would, however, be very helpful for the Service to issue guidance confirming this analysis, and whether a prototype plan could adopt a provision going beyond employee deferrals (plus earnings) and still be able to rely on its opinion letter.

Finally, some members have asked whether benefits based on differential pay that meet the requirements of section 105(b) must be excluded from nondiscrimination testing. Section 105(b) provides that, provided all employees of the employer are entitled to receive differential wage payments on substantially equivalent terms and to have similar contributions made on their behalf, "the plan shall not be treated as failing to meet the requirements of any provision described in paragraph (1)(C) by reason of any contribution or benefit which is based on the differential wage payment." We believe that the better interpretation of this provision is that these contributions need not be excluded from nondiscrimination testing in all cases but, instead, may be included in nondiscrimination testing as long as they do not cause a plan to fail. An interpretation that requires that these contributions be excluded from nondiscrimination testing regardless of their testing impact would require significant programming to flag them for this purpose. Given the late date, several of our members have serious concerns as to whether there would be time to accomplish such programming before January 1, 2009. We recommend guidance on this issue as soon as possible.

Remedial Amendment Period

Finally, questions have been raised about the remedial amendment period for amendments to comply with sections 104, 105 and 107 of the HEART Act. Sections 104 and 105 have statutory remedial amendment provisions, but section 107 does not.

A threshold question is the scope of the remedial amendment provision, specifically, whether it applies to both sections 104(a) and (b), and whether it applies to section 107. We strongly believe that the better reading is that the remedial amendment period applies broadly to all of section 104. Moreover, we believe it should also apply to section 107. Section 107 makes permanent the waiver of the 10 percent addition to income tax for a qualified reservist distribution. However, section 401(k)(2)(B)(i)(V) of the Code allows for qualified reservist distributions starting on the date the period

defined in Code section 72(t)(2)(G)(iii) so that section 107 effectively extends the availability of qualified reservist distributions as well. Many plans will need to be amended to reflect that qualified reservist distributions are now permanent, and it is appropriate that such amendments get the benefit of the same remedial amendment period that applies to sections 104 and 105.

More generally, we believe that the remedial amendment provisions of the HEART Act should be broadly construed and that the remedial amendment period should include discretionary amendments. For example, we anticipate that some employers will choose to amend their plans to provide for in-service distributions of both elective and non-elective contributions in the event of qualified military service, notwithstanding that the HEART Act only specifically addresses elective contributions. However, amendments for nonelective and matching contributions should be within the ambit of the remedial amendment period given the close nexus to the HEART Act.

* * *

We greatly appreciate your consideration. If you have any questions, please don't hesitate to call the undersigned at (202) 289-6700.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jan Jacobson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jan Jacobson
Senior Counsel, Retirement Policy
American Benefits Council

cc: Martin L. Pippins