

Automation Alley Newsletter

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Heroes Act Improves Employee Benefits for Military Personnel

On June 17, 2008, President Bush signed the Heroes Earnings Assistance and Relief Tax Act of 2008 ("Heroes Act") into law. The Heroes Act primarily improves the pay and benefits rights of employees in military service. A description of the main provisions of the Heroes Act follows.

Retirement Plan Benefits

The Heroes Act requires qualified retirement plans, §403(b) plans and §457(b) plans to extend additional benefits to surviving beneficiaries of plan participants who die while performing military service. Specifically, survivors of participants who die in military service must be entitled to any additional benefits that would have been provided under the plan had the participant resumed employment with the employer maintaining the plan and then terminated employment on account of death. These benefits include accelerated vesting, ancillary life insurance benefits, or other survivor benefits that are contingent upon a participant's termination of employment on account of death. Benefits that would have accrued during the period of military service do not have to be provided.

For benefit accruals, retirement plans have the option of treating a participant who cannot be reemployed on account of death or disability related to military service as if the participant had become an active employee the day before the death or disability and then died or became disabled the next day. If the retirement plan implements this provision, the plan must provide benefit accruals for all such participants on a reasonably equivalent basis. If the rule is used for the purposes of calculating matching contributions, the plan must determine the rate of elective deferrals or employee contributions on the basis of the actual average contributions or deferrals made by the participant during the 12-month period prior to military service (or, if less, the average for the actual period of service).

Differential Wage Payments

Some employers voluntarily provide compensation to employees in military service for a period of time. For plan years starting after 2008, the Heroes Act defines a "differential wage payment" for qualified retirement plan, §403(b) plan and §457(b) plan purposes as:

- (1) an employer payment
- (2) to an individual serving on active duty in the uniformed services for more than 30 days
- (3) that represents wages the individual would have received if such individual were performing services for the employer

If an employer makes differential wage payments, the payment is required to be treated as compensation of that employee on which plan contributions or benefits may be based. Any contribution or benefit that is based on differential wage payments will not cause the retirement plan to fail to meet minimum participation and nondiscrimination requirements, provided all employees are entitled to differential wage payments on reasonably equivalent terms and are

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entitled to make contributions based on such differential payments on reasonably equivalent terms.

Plan Distributions

For plan years starting after 2008, if an employee performs military service while on active duty for more than 30 days, the Heroes Act treats the employee as having been severed from employment during that period. This allows an employee on military service to receive a distribution of:

- (1) elective deferrals under a §401(k)
- (2) elective deferrals under a §403(b) tax-sheltered annuity plan
- (3) amounts held in a §403(b)(7) custodial account
- (4) amounts deferred under a §457(b) plan

If any amounts are distributed under this rule, the individual must be prohibited from making elective deferrals or employee contributions to the plan during the six-month period beginning on the date of distribution.

Qualified Reservist Distributions

Currently, a pre-age 59 ½ withdrawal from a §401(k) plan, §403(b) plan, or similar arrangement is exempt from the 10% early withdrawal excise tax if considered a "qualified reservist distribution." To be a "qualified reservist distribution" for this purpose, the withdrawal had to be made (1) to an individual ordered or called to active duty after September 11, 2001 and before December 31, 2007 for a period in excess of 179 days or for an indefinite period and (2) during the period beginning on the date of the order or call to duty and ending at the close of the active duty period. The Heroes Act eliminated the December 31, 2007 limit, extending the excise tax exemption for those ordered or called to active duty after December 31, 2007.

The Heroes Act also added 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 the date of enactment of the Heroes 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.

Extension of Mental Parity Act

The Heroes Act extended the mental health parity requirements that apply to group health plans through December 31, 2008.

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Complying with the Heroes Act

The provision pertaining to additional benefits is effective for deaths and disabilities which occur on or after January 1, 2007. The provisions pertaining to differential wage payments and plan distributions are effective with respect to plan years beginning after December 31, 2008. Plans must be amended to comply with the Heroes Act no later than the last day of the first plan year beginning on or after January 1, 2010. A plan may nevertheless be amended retroactively to the effective dates, provided the plan is operated in compliance as of the effective date specified in the retroactive amendment. Finally, the sponsor of a health FSA should consider whether they want to add the "use it or lose it" exception for qualified reservist distributions.

If you have questions regarding the Heroes Act or other employee benefits matters, please contact your regular Butzel Long attorney, a member of the Butzel Long Employee Benefits Practice Group, or the author of this e-mail news alert.

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