

Employee Benefits Briefing

HEART Act Impacts Benefits for Military Employees

President Bush signed the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act) into law on June 17, 2008. The HEART Act permits, and in some cases requires, plans to provide enhanced benefits for military personnel. The HEART Act also extends parity of mental health benefits in group health plans and changes rules relating to withholding requirements for expatriates.

Military Provisions

No Penalty for Early Withdrawal from 401(k), 403(b) or 457(b) Plans

The new law makes permanent the exemption from the 10% early withdrawal penalty for withdrawals by reservists called to active duty for at least 180 days. A reservist is also permitted to recontribute the amount withdrawn to an individual retirement account within two years of the last day of active service.

Qualified Plan Death Benefits

Effective as of January 1, 2007, in the case of death during qualified military service, an employee must be treated as if he or she had died while actively employed (but not for purposes of benefit accruals). Many plans provide for accelerated vesting or ancillary death benefits upon death during active employment. As a result, plan

administrators need to determine if this new requirement will retroactively vest any survivor benefits. This requirement applies to qualified plans, 403(b) plans and governmental 457(b) plans.

Benefit Accruals

The HEART Act also permits, but does not require, plans to treat a participant who dies or becomes disabled while performing qualified military service to be treated as if the participant had resumed employment. This will result in participants' being credited with their time in military service for benefit accrual purposes. In addition, the HEART Act permits the employer to make up any employee contributions missed by such participants based on the participants' actual contributions during the 12-month period immediately preceding the qualified military service. If an employer provides for additional accruals or contributions, all qualifying participants must be treated on a reasonably equivalent basis. An employer may elect to apply this provision as early as January 1, 2007.

Treatment of Differential Pay

Effective January 1, 2009, differential wage payments made to military personnel must be treated as W-2 wages (previously, these amounts were reported on Form 1099). As such, these payments are subject to federal income tax withholding and must be

treated as compensation for determining contributions and benefits under the employer's retirement plans.

Distributable Event

The HEART Act provides that an individual in qualified military service for more than 30 days and receiving differential pay must be treated as having a severance from employment, and therefore eligible to receive a distribution of elective deferrals. However, if the individual takes a distribution, he/she will be barred from making elective deferrals or employee contributions for six months. This provision is effective for plan years beginning after December 31, 2008.

Health Flexible Spending Account (FSA) Payouts

The HEART Act allows a healthcare flexible spending account to permit reservists called to active duty for 180 days or more to withdraw all or a portion of any unused money (notwithstanding the normal "use it or lose it" rule). The distribution of these funds must be made during the period from the date of call-up until the last day the benefits could normally be reimbursed for the plan year. Although the HEART Act does not address the issue, it would appear that this distribution would be taxable. The provision is optional and may be applied to distributions after June 17, 2008.

Plan Amendments

Any plan amendments required to reflect these new rules must be adopted by the end of the 2010 plan year.

Non-Military Provisions

Expatriate Withholding

The HEART Act requires 30% withholding on distributions of eligible deferred compensation for U.S.

citizens who relinquish their citizenship and long-term residents who terminate their residency on or after June 17, 2008. This applies to qualified plans, 403(b) plans, 457(b) plans, interests in a foreign pension plan, deferred compensation and payments received in connection with performing services to the extent not included in income under Section 83. Certain accounts, including health savings accounts, IRAs and Section 529 accounts, must be

treated as having been distributed the day before the expatriation date.

Extension of Mental Health Benefits

The HEART Act also extends the current mental health parity rules for group health plans through 2008 while Congress continues to consider other legislation that would make the parity rules permanent.

VEDDERPRICE®

222 NORTH LASALLE STREET
CHICAGO, ILLINOIS 60601
312-609-7500 FAX: 312-609-5005

1633 BROADWAY, 47th FLOOR
NEW YORK, NEW YORK 10019
212-407-7700 FAX: 212-407-7799

875 15th STREET NW, SUITE 725
WASHINGTON, D.C. 20005
202-312-3320 FAX: 202-312-3322

www.vedderprice.com

The Employee Benefits Group

Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars.

Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their sponsors. Our clients include large national corporations, smaller professional and business corporations, multi-employer trust funds, investment managers and other plan fiduciaries.

Employee Benefits Group Members

Mark I. Bogart	312-609-7878
Sara Stewart Champion	212-407-7785
Michael G. Cleveland	312-609-7860
Christopher T. Collins	312-609-7706
Megan J. Crowhurst	312-609-7622
Thomas P. Desmond	312-609-7647
John H. Eickemeyer	212-407-7760
Thomas G. Hancuch	312-609-7824
Jonathan E. Hyun	312-609-7791
John J. Jacobsen, Jr.	312-609-7680
Michael C. Joyce	312-609-7627
Neal I. Korval	212-407-7780
Philip L. Mowery (Practice Leader)	312-609-7642
Stewart Reifler	212-407-7742
Paul F. Russell	312-609-7740
Robert F. Simon	312-609-7550

Patrick W. Spangler	312-609-7797
Kelly A. Starr	312-609-7768
Lawrence L. Summers	312-609-7750
Jessica L. Winski	312-609-7678
Charles B. Wolf	312-609-7888

About Vedder Price

Vedder Price P.C. is a national, business-oriented law firm with over 260 attorneys in Chicago, New York and Washington, D.C. The firm combines broad, diversified legal experience with particular strengths in labor and employment law, employee benefits, executive compensation, corporate finance and transactions and commercial litigation.

Employee Benefits Briefing is published by the law firm of Vedder Price P.C. It is intended to keep our clients and other interested parties generally informed of legal developments in employee benefits. It is not a substitute for professional advice. For purposes of the New York State Bar Rules, this bulletin may be considered ATTORNEY ADVERTISING. Prior results do not guarantee a similar outcome.

© 2008 Vedder Price P.C. Reproduction is permissible with credit to Vedder Price P.C.