

## EMPLOYEE BENEFITS ALERT

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### **HEROES ACT REQUIRES PLAN AMENDMENTS**

The Heroes Earnings Assistance and Relief Tax Act of 2008 (the “Act”) was recently enacted and requires certain plan amendments relating to participants on qualified military leave. The Act also contains new withholding rules for deferred compensation paid to certain expatriates. A general description of the most significant of these new rules appears below.

#### **I. Military Service Provisions**

The changes described below have different effective dates, at which point plans must comply in operation, but plans do not need to be formally amended to incorporate the new rules until the last day of the 2010 plan year (2012 for governmental plans)

#### **A. Required Changes**

##### **1. Survivor Benefits**

Qualified retirement plans must provide that the beneficiary of a participant who dies while performing qualified military service is entitled to any additional benefits (other than benefits earned during military service) that would have applied if the participant had returned to work and then terminated on account of death. For instance, a plan that provides special death benefits (e.g., full and immediate vesting upon death or other survivor benefits that are contingent on death) must provide such benefits to the participant’s beneficiary if the participant dies during qualified military service. Similar rules apply to 403(b) and 457(b) plans. These rules apply to deaths occurring on or after January 1, 2007.

##### **2. Treatment of Differential Pay**

Although regulations under prior law allowed differential pay to be treated as compensation for certain purposes, the Act provides that differential pay must be treated as compensation (for retirement plan purposes) and as wages (for income tax withholding purposes). These rules are generally applicable during 2009 (i.e., differential pay should be treated as wages for withholding purposes on or after January 1, 2009 and such pay should be treated as compensation for plan purposes beginning in the 2009 plan year).

##### **3. Plan Distributions**

If a participant in a plan providing for elective contributions (i.e., a 401(k), 403(b), or 457(b) plan) is on active duty for more than 30 days, the participant must be treated as having terminated employment for purposes of determining whether he/she may receive a distribution of such contributions. However, if a participant elects to receive such a distribution, the participant may not make an elective deferral or employee contribution for six months thereafter.

These rules apply beginning on January 1, 2009 and plans will need to be operated in accordance with these rules.

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### 4. Penalty Waiver

The ten percent additional tax on early distributions (i.e., before age 59½) from qualified retirement plans does not apply to qualified reservists ordered or called to active duty after September 11, 2001. This change eliminates the requirement that the participant had to be called to active duty prior to 2008.

This change is effective for all participants ordered or called to active duty on or after December 31, 2007 and does not require a plan amendment.

### **B. Optional Changes**

#### 1. Death / Disability Accruals

In order to provide a deceased or disabled participant the benefit accruals that the plan is required to provide under USERRA, a plan may be amended to treat such participants as if they had resumed employment on the day before the death or disability and then died or became disabled on the date such events actually occurred. This rule applies to deaths or disabilities occurring on or after January 1, 2007.

#### 2. FSA Distributions

A health FSA may permit a tax-free distribution of all or part of a participant's account if (i) the participant is a reservist called to active duty for at least 180 days and (2) the distribution is made between the date of the call to active duty and the end of the coverage period that includes the date of the call. This rule applies to distributions made on or after June 17, 2008.

### **II. Expatriate Provisions**

The Act contains a new rule that affects income tax withholding on deferred compensation paid to "covered expatriates." In general, the Act requires that an employer withhold 30 percent of deferred compensation payments made to such individuals.

The Act defines "expatriate" as (i) any U.S. citizen who relinquishes his citizenship and (ii) any long-term resident of the U.S. (i.e., a non U.S. citizen who was a permanent U.S. resident for at least 8 of the 15 years leading up to the date of expatriation) who ceases to be a permanent resident of the United States. The Act defines "covered expatriate" as an expatriate who (a) has an average annual income tax of more than \$124,000; (b) has net worth of \$2 million or more; or (c) fails to make certain certifications required by the IRS.

The new withholding rule is effective June 17, 2008.

### Contact Us

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