

Benefit Brief



SUBJECT: Heroes Earnings Assistance and Relief Tax (HEART) Act

DATE: October 24, 2008

This Benefit Brief discusses the HEART Act and how it affects health FSAs, the pay employees may receive while on USERRA/Military Leave of Absence, and a tax credit for employers.

The Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 provides enhanced cafeteria and retirement plan benefits for military personnel and their families. The HEART Act was signed into law in June by President Bush. It modifies some provisions of the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) and creates additional benefits for employees in qualified military service.

Health Flexible Spending Accounts (FSAs)

Military reservists who are called to active duty can now receive a qualified reservist distribution (QRD) from unused funds in their health care flexible spending accounts without penalties. Employers may amend their health FSAs to allow reservists called to active duty to withdraw all or part of the balance in their account. The employee must be called to active duty for at least 180 days. The QRD must be requested on or after the day the reservist is called to active duty, and on or before the last day of the plan year (or any applicable grace period) in which the reservist is called to active duty. The employer should receive a copy of the employee's order or call to active duty before the QRD is paid. The employer must pay the QRD within a reasonable time, not to exceed 60 days after the employee requests a QRD. This change allows reservists to avoid forfeiting the money under the "use it or lose it" rule that generally applies to cafeteria plan benefits.

The amount of the QRD may be the entire amount elected for the health FSA for the plan year minus health FSA reimbursements received as of the date of the QRD request, or the amount contributed to the health FSA as of the date of the QRD request minus health FSA reimbursements received as of that date, or some other amount not exceeding the entire amount elected for the health FSA for the plan year minus reimbursements. The amount available should be stated in the plan document. The plan must permit employees to submit claims for expenses incurred before the date of the QRD request. However, the plan may either allow employees to continue to submit claims incurred after that date or terminate their right to submit claims.

A QRD is included in the employee's gross income and wages, is subject to employment taxes, and must be reported as wages on the employee's W-2 for the year in which the QRD is paid.

This provision of the HEART Act is optional and applies to distributions received on or after June 17, 2008. If employers chose to adopt this provision, they will need to amend their FSA plans to permit the distributions to qualified military reservists. QRDs should not be made before the cafeteria plan is amended. However, a plan may be retroactively amended by December 31, 2009 to permit QRDs requested on or before that date, if certain requirements are met. Employers also must notify all participants in their cafeteria plans of the changes by providing them with summaries of material

modifications (SMMs). Contact Benecon's Compliance Division for assistance in amending your documents.

Differential Wage Payments

Some employers chose to continue to pay their employees on active duty the compensation they would have received had they been at work. Other employers may pay their employees on active duty the difference between their military pay and compensation they would have received from their employer had they been at work. The HEART Act defines *differential wage payments* as any amount that represents all or a portion of the wages the employee would have received while working for the employer.

Under the HEART Act, differential wage payments made by an employer during any period in which an employee is on active duty for more than 30 days are treated as wages to the employee for purposes of income tax withholding, but not for payroll tax purposes. This provision is effective only for differential wage payments made after December 31, 2008 and is effective for plan years beginning on or after January 1, 2009.

Employers with fewer than 50 employees who provide differential wage payments receive a tax credit of 20% of the eligible differential wage payment for each qualified employee, up to a maximum of \$4,000 per employee. This change may encourage more employers to provide differential wage pay to employees during military leaves of absence. This HEART provision is effective for amounts paid between June 17, 2008 and January 1, 2010.

Mental Health Parity Requirements

The HEART Act extends through the end of 2008 the mental health parity requirements that apply to group health plans. The Mental Health Parity Act prevents employer-sponsored health plans from imposing annual or lifetime dollar limits on mental health benefits if they are not imposed on medical or surgical benefits.

Retirement Benefits

There are also provisions of the HEART Act that affect the administration of tax-qualified retirement plans. The changes involve survivor benefits, additional benefit accruals, distribution of elective deferrals, extension of exemption from early withdrawal penalty, and rollovers to Roth IRAs for military personnel and their beneficiaries.

If you have questions about the HEART Act, please contact Danielle Omans at The Benecon Group at domans@benecon.com or the number below.

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