

## Part III - Administrative, Procedural and Miscellaneous

### **Miscellaneous HEART Act Changes**

#### **Notice 2010-15**

##### **I. Purpose and background**

This notice provides guidance in the form of questions and answers with respect to certain provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (“HEART Act “ or “Act”), Pub. L. No. 110-245. This notice also requests comments regarding any additional issues relating to the sections of the HEART Act that are addressed in this notice.

The sections of the HEART Act addressed in this notice are section 104 (relating to survivor and disability payments with respect to qualified military service), section 105 (relating to treatment of differential military pay as wages), section 107 (relating to distributions from retirement plans to individuals called to active duty), section 109 (relating to contributions of military death gratuities to Roth IRAs and Coverdell education savings accounts), and section 111 (relating to an employer credit for differential wage payments to employees who are active duty members of the uniformed services).

##### **II. Section 104 of the HEART Act**

###### Background

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 (“USERRA”), Pub. L. No. 103-353, an employee who leaves a civilian job for qualified military service generally is entitled to be reemployed by the pre-service civilian employer if the individual returns to employment within a

specified period and meets the other eligibility criteria under USERRA. USERRA also provides that an individual, upon reemployment, is entitled to receive certain pension, profit-sharing, and similar benefits that would have been received but for the employee's absence during military service.

Section 414(u) of the Internal Revenue Code ("Code") provides rules regarding the interaction of USERRA with the rules governing tax-qualified retirement plans. Section 414(u)(8) provides, in part, that an employer maintaining a plan is treated as meeting the requirements of USERRA only if: an employee reemployed under USERRA is treated as not having incurred a break in service because of the period of military service, the employee's military service is treated as service with the employer for vesting and benefit accrual purposes, the employee is permitted to make additional elective deferrals and employee contributions in an amount not exceeding the maximum amount the employee would have been permitted or required to contribute during the period of military service if the employee actually had been employed by the employer during that period, and the employee is entitled to any accrued benefits that are contingent on employee contributions or elective deferrals to the extent the employee pays the contributions or elective deferrals to the plan.

#### Section 104(a)

Section 104(a) of the HEART Act adds § 401(a)(37) to the Code. Under § 401(a)(37), qualified retirement plans must provide that, in the case of a participant who dies while performing qualified military service, the survivors of the participant are entitled to any additional benefits (other than benefit accruals

relating to the period of qualified military service) that would have been provided under the plan had the participant resumed employment and then terminated employment on account of death. Under section 104(c) of the Act, this new tax qualification requirement also applies to tax-deferred annuities under § 403(b) of the Code and to governmental eligible deferred compensation plans under § 457(b).

Section 104(d)(1) of the Act states that the amendments made by section 104 of the Act apply with respect to deaths and disabilities occurring on or after January 1, 2007.

Q-1. What types of additional benefits provided by a plan are subject to § 401(a)(37) of the Code?

A-1. Section 401(a)(37) requires that the survivors of a participant who dies while performing qualified military service be entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) that would be provided under the plan if the participant had resumed employment and then terminated employment on account of death. The types of benefits subject to § 401(a)(37) include accelerated vesting, ancillary life insurance benefits, and other survivor's benefits provided under a plan that are contingent on a participant's termination of employment on account of death.

Q-2. If the amount of death benefits provided under a plan is based on the amount of the deceased participant's accrued benefit, does § 401(a)(37) require that the death benefit be determined as if the participant had received benefit accruals for the period of qualified military service?

A-2. No. Section 401(a)(37) specifically excepts benefit accruals for the period of qualified military service from the additional benefits to which survivors must be entitled in the case of a participant who dies while performing such service. Accordingly, § 401(a)(37) does not require that benefit accruals (whether benefit accruals under a defined benefit plan or contributions under a defined contribution plan) be imputed for the period of qualified military service for purposes of determining death benefits that are based on a deceased participant's accrued benefit.

Q-3. Does § 401(a)(37) require that service credit for vesting purposes be provided for the period of a deceased participant's qualified military service for purposes of determining death benefits under the plan?

A-3. Yes. Section 401(a)(37) requires that the survivors of a participant be entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) provided under the plan had the participant resumed employment and then terminated employment on account of death. Section 414(u)(8)(B) provides that each period of an individual's qualified military service is, upon reemployment, deemed to constitute service with the employer for vesting and accrual purposes. Although § 401(a)(37) provides an exception for benefit accruals for the period of qualified military service, there is no exception for vesting service. Accordingly, even though § 401(a)(37) does not require that benefit accruals be provided for the deceased participant's period of qualified military service, service credit for the period of the deceased

participant's period of qualified military service must be provided (due to the interaction of §§ 401(a)(37) and 414(u)(8)(B)) for vesting purposes.

Q-4. Does § 401(a)(37) apply in the case of a plan participant who dies while performing military service, but who was not entitled to reemployment rights with respect to the employer maintaining the plan?

A-4. No. Section 401(a)(37) provides that a qualified plan must provide that, in the case of a participant who dies while performing qualified military service (as defined in § 414(u)), the participant's survivors are entitled to certain death benefits. Section 414(u)(5) defines qualified military service with respect to an individual as any service in the uniformed services by an individual entitled to reemployment rights under USERRA. Therefore, if a participant would not be entitled to reemployment rights with respect to an employer under USERRA if the participant had applied for reemployment rights immediately before his or her death, § 401(a)(37) does not apply in determining the death benefits to which the participant's survivors are entitled under the employer's plan. For information regarding reemployment rights under USERRA, see <http://www.dol.gov/vets/programs/userra/main.htm>.

#### Section 104(b)

Section 104(b) of the HEART Act adds a new § 414(u)(9) to the Code. Under § 414(u)(9), an employer sponsoring a retirement plan may, for benefit accrual purposes, treat an individual who dies or becomes disabled while performing qualified military service as if the individual had resumed employment in accordance with the individual's USERRA reemployment rights on the day

preceding the death or disability and then terminated employment on the actual date of death or disability. Section 414(u)(9) also provides that this provision applies only if all individuals performing qualified military service with respect to the employer maintaining the plan who die or become disabled as a result of performing qualified military service prior to reemployment by the employer are credited with service and benefits on reasonably equivalent terms. Section 414(u)(9)(C) provides that the amount of employee contributions and the amount of elective deferrals of an individual treated as reemployed under § 414(u)(9) are determined on the basis of the individual's average actual employee contributions or elective deferrals for the lesser of: (1) the 12-month period of service with the employer immediately prior to qualified military service, or (2) the actual length of continuous service with the employer.

Section 104(d)(1) of the Act states that the amendments made by section 104 of the Act apply with respect to deaths and disabilities occurring on or after January 1, 2007.

Q-5. May § 414(u)(9) of the Code be applied to a plan as of any date on or after January 1, 2007?

A-5. Yes. Under section 104(d) of the HEART Act, § 414(u)(9) of the Code applies to deaths and disabilities occurring on or after January 1, 2007.

However, because the provisions of § 414(u)(9) are permissive rather than mandatory, they may be applied beginning as of any date on or after January 1, 2007. For nondiscrimination rules regarding the timing of plan amendments, see § 1.401(a)(4)-5 of the Income Tax Regulations.

Q-6. If, for benefit accrual purposes, a plan provides under § 414(u)(9)(A) for treatment of an individual who dies while performing qualified military service as if the individual had resumed employment, must the plan also provide vesting credit for that service?

A-6. Yes. As described in Q&A-3 above, under §§ 401(a)(37) and 414(u)(8)(B), vesting credit must be provided for the period of the deceased individual's period of qualified military service. This vesting credit is taken into account for purposes of determining a participant's vested percentage in accruals earned both during qualified military service and during other periods.

Q-7. If, for benefit accrual purposes, a plan provides under § 414(u)(9)(A) for treatment of an individual who becomes disabled while performing qualified military service as if the individual had resumed employment, must the plan also provide vesting credit for that service?

A-7. No. Section 414(u)(9) applies only for benefit accrual purposes and neither that section nor any other Code section requires that a plan provide vesting credit to a disabled individual under these circumstances. However, § 414(u)(9) does not prohibit plans from providing vesting credit for a disabled individual's qualified military service to the extent permitted under other applicable rules, including § 1.401(a)(4)-11(d)(3), which provides nondiscrimination rules for crediting imputed service, i.e., service other than actual service with the employer.

Under § 1.401(a)(4)-11(d)(3), there must be a legitimate business reason for crediting the imputed service (which is deemed to exist in the case of credit for military service), the plan provision crediting the imputed service to any highly

compensated employee (HCE) must apply on the same terms to all similarly-situated nonhighly compensated employees (NHCEs), and the plan provision must not by design or in operation discriminate significantly in favor of HCEs. Pursuant to the authority granted by § 1.401(a)(4)-1(d), imputed service for a period of qualified military service that is credited for vesting purposes to an individual who became disabled while performing qualified military service will satisfy these requirements if the plan provision crediting the service to any HCE applies on the same terms to all similarly-situated NHCEs.

Q-8. How may a plan determine employer-provided contributions or benefits for an individual treated as reemployed under § 414(u)(9) when those contributions or benefits are contingent on the individual's employee contributions or elective deferrals?

A-8. Section 414(u)(9) does not provide for actual employee contributions or elective deferrals. Instead, under § 414(u)(9)(C), an individual who dies or becomes disabled while performing qualified military service is deemed to have made employee contributions or elective deferrals for the purpose of determining benefits under § 414(u)(8)(C) that are contingent on employee contributions or elective deferrals. Under § 414(u)(9)(C), for this purpose, the individual is deemed to have made employee contributions or elective deferrals in an amount equal to the lesser of the actual average employee contributions or elective deferrals made by the individual under the plan during the 12-month period prior to military service or, if service with the employer is less than 12 months, the



average actual employee contributions or elective deferrals for the actual length of continuous service with the employer.

However, in the case of a disabled individual who is covered by a plan that permits disabled individuals to make employee contributions or elective deferrals and who is treated as reemployed under § 414(u)(9), § 414(u)(9) does not prohibit the plan from allowing the disabled individual to make elective deferrals or employee contributions with respect to periods of qualified military service in the amounts permitted under § 414(u)(8)(C) without regard to § 414(u)(9). In that case, § 414(u)(9) also does not prohibit the plan from determining the disabled individual's employer-sponsored contributions or benefits based on the actual employee contributions or elective deferrals made by the disabled individual.

### **III. Section 105 of the HEART Act**

In the case of employees who are called to active duty, some employers have paid some or all of the compensation that a service member would have received from the employer during the service member's period of active duty had the employee not been called to active duty. Prior to the enactment of the HEART Act, these payments, commonly referred to as "differential wage payments," were not treated as wages for Federal employment tax purposes, pursuant to Rev. Rul. 69-136, 1969-1 C.B. 252.

Section 105(a) of the HEART Act amends § 3401 of the Code to treat differential wage payments as wages for income tax withholding purposes. The term "differential wage payment" is defined in § 3401(h) as any payment which (1) is made by an employer to an individual with respect to any period during

which the individual is performing service in the uniformed services while on active duty for a period of more than 30 days, and (2) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer. This amendment applies to remuneration paid after December 31, 2008. See Rev. Rul. 2009-11, 2009-18 I.R.B. 896, for guidance relating to § 3401(h).

Section 105(b)(1)(A) of the Act adds § 414(u)(12)(A) to the Code, which provides that, for purposes of applying the Code to retirement plans subject to § 414(u), (1) an individual receiving a differential wage payment is treated as an employee of the employer making the payment, (2) the differential wage payment is treated as compensation, and (3) the plan is not treated as failing to meet the requirements of any provisions described in § 414(u)(1)(C) by reason of any contribution or benefit which is based on the differential wage payment. The provisions described in § 414(u)(1)(C) include various nondiscrimination requirements, including requirements under §§ 401(a)(4), 401(k)(3), and 401(m).

Section 105(b)(1)(A) of the Act also adds § 414(u)(12)(B) to the Code, under which, notwithstanding the treatment of an individual receiving differential wage payments as an employee, an individual is treated for purposes of distributions (including distributions from a designated Roth account under § 402A) under §§ 401(k)(2)(B)(i)(I), 403(b)(7)(A)(ii), 403(b)(11)(A), and 457(d)(1)(A)(ii) as having been severed from employment during any period the individual is performing service in the uniformed services described in § 3401(h). Section 414(u)(12)(B)(ii) provides that, if an individual elects to receive a

distribution under this provision, the plan must provide that the individual may not make an elective deferral or employee contribution during the 6-month period beginning on the date of the distribution. For purposes of the 6-month restriction, the definition of “elective deferral” under § 414(u)(2)(C) applies, which includes any deferral of compensation under an eligible deferred compensation plan under § 457(b).

Section 105(b)(2) of the Act amends § 219(f)(1) of the Code to provide that, for purposes of determining the limitation on contributions to an IRA, the term “compensation” includes differential wage payments.

The amendments made by section 105(b) of the Act apply to years beginning after December 31, 2008.

Q-9. Must differential wage payments be treated as compensation for purposes of determining contributions and benefits under a plan?

A-9. No. Differential wage payments are not required to be treated as compensation for purposes of determining contributions and benefits under a plan. However, such payments are treated as compensation for purposes of applying the Code. Accordingly, these payments must be treated as compensation under § 415(c)(3) and § 1.415-2(d).

Q-10. Will a plan’s definition of compensation fail to satisfy § 414(s) if differential wage payments are excluded from the plan’s definition of compensation for purposes of determining benefits and contributions under the plan?

A-10. No. A plan’s definition of compensation will not fail to satisfy § 414(s) merely because differential wage payments are excluded from the plan’s

definition of compensation for purposes of determining benefits and contributions.

Q-11. Is the rule in § 414(u)(12)(B) which treats an individual as severed from employment while performing service in the uniformed services limited to individuals receiving differential wage payments?

A-11. No. Section 414(u)(12)(B) applies to all individuals on active duty for a period of more than 30 days, regardless of whether they are receiving differential wage payments. Thus, for purposes of applying rules that permit distributions upon severance from employment under §§ 401(k), 403(b), and 457(d), an individual is treated as having been severed from employment during any period the individual is performing service in the uniformed services while on active duty for a period of more than 30 days.

Q-12. Is a plan required to provide for distributions to an individual who is treated as severed from employment while performing service in the uniformed services pursuant to § 414(u)(12)(B)?

A-12. No. Just as a plan may, but is not required to, provide for distributions under § 401(k), 403(b), or 457(d) upon actual severance from employment, a plan may, but is not required to, provide for distributions upon a deemed severance from employment under § 414(u)(12)(B). Thus, for example, a plan that provides for distributions upon severance from employment may, but is not required to, also provide for distributions upon a deemed severance from employment under § 414(u)(12)(B). If a plan provides for a distribution upon a deemed severance from employment under § 414(u)(12)(B), the plan must also

provide that an individual receiving the distribution may not make an elective deferral or employee contribution during the 6-month period beginning on the date of the distribution.

Q-13. How does the deemed severance rule of § 414(u)(12)(B) affect other rules applicable to plan distributions?

A-13. Section 414(u)(12)(B) applies only for purposes of the provisions of §§ 401(k), 403(b), and 457(d) that permit distributions on severance from employment. Thus, for example, in the event an individual is treated as severed from employment under § 401(k)(2)(B)(i)(I), the individual may receive a distribution otherwise subject to the distribution restrictions of § 401(k)(2)(B). On the other hand, merely because an individual is treated as severed from employment under § 414(u)(12)(B) does not cause such individual to be treated as severed from employment under sections of the Code other than §§ 401(k)(2)(B)(i)(I), 403(b)(7)(A)(ii), 403(b)(11)(A), and 457(d)(1)(A)(ii).

Q-14. Does § 414(u)(12)(B) apply to individuals who have an actual severance from employment or who otherwise are eligible to take a distribution of plan benefits?

A-14. No. Section 414(u)(12)(B) does not affect the status of an individual who is on active duty for a period of more than 30 days and who has, in fact, had a severance from employment. Thus, for example, if such an individual receives a distribution from a retirement plan under § 401(k)(2)(B)(i)(I) and returns to employment within six months, § 414(u)(12)(B)(ii) would not preclude the

individual from making elective deferrals (as defined under § 414(u)(2)(C)) or employee contributions to the plan before the end of the 6-month period.

Section 414(u)(12)(B) also does not affect a plan's ability to make other in-service distributions to the extent permitted under other applicable rules and plan terms. Thus, for example, a § 401(k) plan may distribute a participant's elective deferrals when the participant attains age 59 ½, or under other circumstances listed in § 401(k)(2)(B), and the distribution would not be subject to the 6-month restriction on elective deferrals under § 414(u)(12)(B) (although a 6-month restriction may apply under § 401(k) to a distribution on account of a financial hardship under § 401(k)(2)(B)(i)(IV)).

Q-15. If an individual is eligible under a plan to receive a distribution under § 401(k)(2)(B)(i)(I) as a result of a deemed severance from employment under § 414(u)(12)(B), and is also eligible under the plan to receive a qualified reservist distribution within the meaning of § 72(t)(2)(G)(iii), as permitted under § 401(k)(2)(B)(i)(V), what treatment applies to a distribution that could be made under § 401(k)(2)(B)(i)(I) or under § 401(k)(2)(B)(i)(V)?

A-15. If an individual receives a distribution that meets the definition of a qualified reservist distribution under § 72(t)(2)(G)(iii), the distribution will be treated as a qualified reservist distribution, even if the distribution would also have been permitted as a result of a deemed severance of employment under § 414(u)(12)(B). For example, if a plan provides for qualified reservist distributions and for distributions on deemed severance under § 414(u)(12)(B), a distribution to an individual that could be either type of distribution will be treated

as a qualified reservist distribution. In that case, the distribution would not be subject to the 6-month restriction on elective deferrals or to the 10-percent additional income tax of § 72(t). The rules applicable to qualified reservist distributions are discussed in Section IV, below.

Q-16. Is a distribution made pursuant to § 414(u)(12)(B) an eligible rollover distribution within the meaning of § 402(c)(4)?

A-16. Yes. A distribution made pursuant to § 414(u)(12)(B) is an eligible rollover distribution within the meaning of § 402(c)(4), except to the extent one of the exceptions listed under § 402(c)(4) (other than the exception for hardship distributions under § 401(k)(2)(B)(i)(IV)) applies. A distribution made pursuant to § 414(u)(12)(B) is not treated as a hardship distribution ineligible for rollover. An eligible rollover distribution that is paid to an employee (rather than directly rolled over) is subject to 20-percent mandatory withholding under § 3405(c).

Q-17. May the contributions and benefits provided as a result of differential wage payments be included in a plan's nondiscrimination testing?

A-17. Yes. Under § 414(u)(12)(A), a qualified plan is not treated as failing to meet the requirements of any nondiscrimination provision described in § 414(u)(1)(C) by reason of any contribution or benefit based on a differential wage payment, as long as the differential wage payment and the ability to make contributions based on the differential wage payment are provided on reasonably equivalent terms. Accordingly, the contributions and benefits provided under a plan as a result of differential wage payments need not be included in the plan's nondiscrimination testing. On the other hand, § 414(u)(1)(C) does not prevent

such contributions and benefits from being taken into account, as long as they do not cause the plan to fail the nondiscrimination requirements. If such contributions and benefits are included in the plan's nondiscrimination testing for any employee, they must be taken into account for all employees.

#### **IV. Section 107 of the HEART Act**

Under current law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59 ½, death, or disability is generally subject to a 10-percent additional income tax under § 72(t) unless an exception applies. Pursuant to amendments made by the Pension Protection Act of 2006 (PPA '06), Pub. L. No. 109-280, § 72(t)(2)(G) of the Code provides that the 10-percent additional income tax does not apply to a qualified reservist distribution.

A qualified reservist distribution is defined under § 72(t)(2)(G)(iii) as a distribution from an IRA or a distribution attributable to elective deferrals under a § 401(k) or 403(b) plan (or a plan described in § 501(c)(18)) to a member of the reserves who has been ordered or called to active duty for a period exceeding 179 days or for an indefinite period. A qualified reservist distribution can be made without regard to otherwise applicable restrictions under §§ 401(k) and 403(b) on in-service distributions of amounts attributable to elective deferrals. In addition, during the two-year period beginning on the day after the end of the individual's active duty service, an individual who receives a qualified reservist distribution may make contributions to an IRA in an amount up to the amount of the qualified reservist distribution, which are not subject to the otherwise applicable limits on IRA contributions and are not deductible.



As originally enacted in PPA '06, these special rules for qualified reservist distributions applied to individuals ordered or called to active duty after September 11, 2001, and before December 31, 2007. Section 107 of the HEART Act amends § 72(t)(2)(G) of the Code to delete the reference to December 31, 2007, so that the special rules for qualified reservist distributions no longer have an expiration date.

#### **V. Remedial Amendment Period for Sections 104, 105, and 107 of the HEART Act**

Section 401(b) provides for a remedial amendment period during which certain plan amendments may be made retroactively effective to enable the plan to comply with the requirements of § 401(a) during that period. Section 1.401(b)-1(a) provides that, under § 401(b), a plan that does not satisfy the requirements of § 401(a) on any day solely as a result of a disqualifying provision (as defined in § 1.401(b)-1(b)) is considered to have satisfied those requirements on that date if, on or before the last day of the remedial amendment period with respect to the disqualifying provision, all provisions of the plan that are necessary to satisfy all requirements of § 401(a) are in effect and have been made effective for all purposes for the whole of the remedial amendment period. Section 1.401(b)-1(b)(1) provides that the term “disqualifying provision” includes a provision of a new plan, the absence of a provision from a new plan, or an amendment to an existing plan which causes the plan to fail to satisfy the requirements of the Code applicable to the qualification of the plan as of the date the plan or amendment is first made effective.

As provided in § 1.401(b)-1(d), the remedial amendment period for a disqualifying provision described in § 1.401(b)-1(b)(1) begins, in the case of a provision of, or absence of a provision from, a new plan, on the date the plan is put into effect, and, in the case of an amendment to an existing plan, on the date the plan amendment is adopted or put into effect (whichever is earlier).

Generally, the remedial amendment period for a disqualifying provision described in § 1.401(b)-1(b)(1) ends with the due date (including extensions) for filing the income tax return for the employer's tax year that includes, in the case of a provision of, or absence of a provision from, a new plan, the date the plan is put into effect, or, in the case of an amendment to an existing plan, the date the plan amendment is adopted or put into effect (whichever is later). Section 1.401(b)-1(f) grants the Commissioner the discretion to extend the remedial amendment period.

Section 1.401(b)-1(b)(3) provides that the Commissioner also may designate as a disqualifying provision under § 401(b) a plan provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements, or (2) is integral to a qualification requirement that has been changed. Under § 1.401(b)-1(d)(1)(iv), in the case of a plan provision that is designated as a disqualifying provision under § 1.401(b)-1(b)(3) and that results in the failure of the plan to satisfy the changed qualification requirements, the remedial amendment period begins on the date on which the change effected by the amendment to the Code became effective with respect to the plan. Under § 1.401(b)-1(d)(1)(v), in the case of a plan provision

that is designated as a disqualifying provision under § 1.401(b)-1(b)(3) and that is integral to a qualification requirement that has been changed, the remedial amendment period generally begins on the first day on which the plan was operated in accordance with the changed qualification requirement. Under § 1.401(b)-1(d)(2)(i), the remedial amendment period for a plan provision that is designated as a disqualifying provision under § 1.401(b)-1(b)(3) generally ends on the date prescribed by law, including extensions, for filing the income tax return of the employer for the employer's taxable year that includes the beginning of the remedial amendment period (unless the remedial amendment period is extended by the Commissioner).

Section 104(d)(1) of the Act provides that the statutory changes made by section 104 of the Act apply with respect to deaths and disabilities occurring on or after January 1, 2007. Section 104(d)(2) of the Act adds that a plan subject to these new provisions is treated as being operated in accordance with the terms of the plan if a plan amendment is made to comply with the requirements of § 401(a)(37) of the Code (which was added by section 104(a) of the Act) and is made on or before the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans). By its terms, section 104(d)(2) of the Act does not apply to plan amendments made pursuant to § 414(u)(9) of the Code (which was added by section 104(b) of the Act).

Section 105(b)(2) of the Act provides that the statutory changes made by section 105(b) of the Act apply to years beginning after December 31, 2008. Section 105(c) of the Act adds that a plan subject to these new provisions is

treated as being operated in accordance with the terms of the plan if a plan amendment is made pursuant to section 105(b)(1) of the Act and is made on or before the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans).

Section 107 of the Act amends § 72(t)(2)(G) of the Code to delete the reference to December 31, 2007, added as part of PPA '06. This amendment applies to individuals ordered or called to active duty on or after December 31, 2007.

Q-18. When must plans be amended to satisfy the requirements of section 104(b) of the Act?

A-18. Pursuant to the authority provided under § 1.401(b)-1(b)(3), plan provisions that relate to the requirements of § 414(u)(9) of the Code (as added by section 104(b) of the Act) are hereby designated as disqualifying provisions.

Moreover, pursuant to the authority granted to the Commissioner under § 1.401(b)-1(f) with respect to disqualifying provisions, plans need not be amended to include any provisions relating to the permissive rules of § 414(u)(9) of the Code until the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans). Thus, the remedial amendment period for section 104(b) of the Act is the same period as the period for making plan amendments pursuant to sections 104(a) and 105(b) of the Act.

Q-19. When must plans be amended to satisfy the requirements of section 107 of the Act?

A-19. Section 72(t)(2)(G)(iv) of the Code, as amended by section 107 of the Act, generally does not affect the qualification of a retirement plan. However, the amendment to § 72(t)(2)(G)(iv) of the Code made by section 107 of the Act also applies under § 401(k)(2)(B)(i)(V) of the Code to the definition of a “qualified reservist distribution.” Pursuant to the authority provided under § 1.401(b)-1(b)(3), plan provisions that relate to the requirements of § 401(k)(2)(B)(i)(V), as extended by section 107 of the Act to individuals called to active duty after December 31, 2007, are hereby designated as disqualifying provisions. Pursuant to the authority granted to the Commissioner under § 1.401(b)-1(f) with respect to disqualifying provisions, the remedial amendment period with respect to these disqualifying provisions is extended so that it ends no earlier than the last day of the first plan year beginning on or after January 1, 2010 (January 1, 2012, for governmental plans).

#### **VI. Section 109 of the HEART Act**

Section 1477 of Title 10 of the United States Code provides for the payment of a military death gratuity to an eligible survivor of a service member. This gratuity is excludable from income under § 134 of the Internal Revenue Code. Section 1967 of Title 38 of the United States Code provides that certain members of the uniformed services are automatically insured against death under the Servicemembers’ Group Life Insurance (SGLI) program. In general, life insurance proceeds are also excludable from income.

Section 408A of the Code provides rules for the tax treatment of Roth IRAs. Contributions to a Roth IRA are not deductible, and “qualified distributions”

(generally distributions made after age 59 ½, death, or disability, and also made after the 5-year period following an initial contribution to any Roth IRA) from a Roth IRA are excluded from income. A distribution that is not a qualified distribution is generally taxed under the rules of §§ 72 and 408A(d)(4), under which the portion of the distribution that is not in excess of the participant's investment in the contract (i.e., basis), taking into account all prior distributions from the owner's Roth IRAs, is not included in income, and any portion of the distribution that exceeds the recipient's investment in the contract is included in income. Subject to certain exceptions, a 10-percent additional income tax on early distributions under § 72(t) will also apply. Contributions to a Roth IRA are subject to annual limits and a phase-out based on income, except for certain rollover contributions to the extent permitted from another IRA or employer-sponsored plan.

For years before 2008, § 408A(e) provided that a Roth IRA could only accept a rollover contribution of amounts distributed from another Roth IRA, from a non-Roth IRA (subject to income limits on conversion of a non-Roth IRA to a Roth IRA), or from a designated Roth account under an employer-sponsored plan described in § 402A. These rollover contributions to Roth IRAs are called "qualified rollover contributions." Section 824 of PPA '06 amended the definition of a qualified rollover contribution in § 408A(e) of the Code to also permit rollovers to Roth IRAs from various types of employer-sponsored plans, even if the rollover is not from a designated Roth account (subject to the income limits

on conversion of a non-Roth IRA to a Roth IRA), effective for distributions made after December 31, 2007.

Section 530 provides rules for the tax treatment of a Coverdell education savings account ("Coverdell ESA"). Contributions to a Coverdell ESA are not deductible and distributions from a Coverdell ESA are generally excluded from income up to the amount of the beneficiary's qualified education expenses, subject to coordination with other tax benefits for education expenses.

Distributions that are not excluded from income are generally taxed under the rules of § 72, under which a portion of the distribution is treated as a nontaxable recovery of the recipient's investment in the contract (i.e., basis) and the remainder is included in income. Subject to certain exceptions, a 10-percent additional income tax on distributions not used for qualified expenses will also apply. Contributions to a Coverdell ESA are subject to an annual limit and a phase-out based on income. Special rules apply in the case of rollover contributions.

Under section 109 of the HEART Act, § 408A(e) of the Code, as in effect both before and after the amendments made by PPA '06, is amended to include as a qualified rollover contribution the contribution to a Roth IRA of a military death gratuity or SGLI payment if the contribution is made before the end of the 1-year period beginning on the date on which the IRA beneficiary receives the military death gratuity or SGLI payment. Thus, the annual limits on Roth IRA contributions and the phase-out based on income do not apply to such a contribution. Section 530 of the Code is similarly amended to treat the

contribution of a military death gratuity or SGLI payment to a Coverdell ESA as a rollover contribution. The annual limit on Coverdell ESA contributions and the phase-out of the annual limit based on income do not apply to such a contribution.

The amount treated as a qualified rollover contribution to a Roth IRA cannot exceed the total amount of the military death gratuity and SGLI payments received, reduced by any portion of such amount contributed to a Coverdell ESA or another Roth IRA. Similarly, the amount treated as a qualified rollover contribution to a Coverdell ESA cannot exceed the total amount of the military death gratuity and SGLI payments received, reduced by any portion of such amount contributed to a Roth IRA or another Coverdell ESA. For purposes of applying § 72 to a distribution from a Roth IRA or Coverdell ESA, the amount treated as a qualified rollover contribution (in the case of a Roth IRA) or as a rollover contribution (in the case of a Coverdell ESA) is treated as investment in the contract.

The amendments made by section 109 of the Act generally apply with respect to deaths from injuries occurring on or after June 17, 2008. In addition, section 109 of the Act permits a contribution to a Roth IRA or a Coverdell ESA of a military death gratuity or an SGLI payment received with respect to a death from injuries occurring before June 17, 2008 (and on or after October 7, 2001), if the contribution is made no later than June 17, 2009.



## **VII. Section 111 of the HEART Act**

Section 111 of the HEART Act adds § 45P to the Code. Section 45P provides a credit to eligible small business employers that make eligible differential wage payments to qualified employees who are on active duty in the uniformed services for more than 30 days. An eligible small business employer may take a credit against its income tax liability in an amount equal to 20 percent of the sum of the eligible differential wage payments made to qualified employees during the taxable year. The definition of eligible differential wage payments for purposes of the § 45P credit is the same definition enacted in new § 3401(h) discussed in Section III, above. The amount of eligible differential wage payments that may be taken into account for the taxable year is limited to \$20,000 per qualified employee, resulting in a maximum credit for a taxable year of \$4,000 per qualified employee. An employee is a qualified employee if he or she has been an employee of the taxpayer for the 91-day period immediately preceding the period for which differential wage payments are made. An employer is an eligible small business employer if it employed an average of fewer than 50 employees on business days during the taxable year and provides differential wage payments under a written plan to every qualified employee. For purposes of determining an employer's eligibility, the rules of § 414(b), (c), (m) and (o) apply, under which the members of a controlled group and other related entities are treated as a single employer.

Section 45P(c) provides a rule to coordinate the § 45P credit with other credits under Chapter 1 of the Code (§§ 1 through 1400T) that are calculated

taking into account employee compensation. Under this rule, the amount of any such other credit determined with respect to compensation of an employee must be reduced by the amount of the § 45P credit determined with respect to that employee.

Q-20. In what circumstances does the credit under § 45P reduce the amount of another credit?

A-20. The amount of another credit under Chapter 1 of the Code determined with respect to compensation of an employee must be reduced by the amount of the § 45P credit determined with respect to that employee if: (1) compensation paid in the current taxable year is an expense used directly in determining the amount of the other credit, (2) military differential wage payments are a type of compensation that can be taken into account in determining the amount of the other credit, and (3) the military differential wage payments taken into account in determining the employer's § 45P credit are also taken into account in determining the other credit.

### **Comments Requested**

The Service is considering issuing additional guidance regarding the above sections of the HEART Act, and comments are requested regarding such possible guidance. Written comments should be submitted by April 9, 2010.

Send submissions to CC:PA:LPD:DRU (Notice 2010-15), Room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20044.

Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday, to CC:PA:LPD:DRU (Notice 2010-15), Courier's Desk,

Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking portal at <http://www.regulations.gov> (Notice 2010-15). All comments will be available for public inspection.

#### **DRAFTING INFORMATION**

The principal authors of this notice are Robert M. Walsh of the Employee Plans, Tax Exempt and Government Entities Division and Joseph Perera of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding Sections I through VI of this notice, please call the Employee Plans taxpayer assistance number between 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday at (877) 829-5500 (a toll-free number) or email Mr. Walsh at [RetirementPlanQuestions@irs.gov](mailto:RetirementPlanQuestions@irs.gov). For further information regarding Section VII of this notice, please contact Mr. Perera at 202-622-6040 (not a toll-free number).