Application of USERRA to 401(k) Plans

August 6, 2003

Carol Gold, Director
TE/GE Employee Plans Division
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Application of USERRA to 401(k) Plans

Dear Ms. Gold:

The American Society of Pension Actuaries (ASPPA) hereby requests guidance that will enable sponsors of qualified retirement plans to administer cash or deferred arrangements in accordance with the intent of the Uniformed Services Employment and Reemployment Rights Act (USERRA). Following the tragic events of September 11, 2001, the war in Iraq, and the resulting call up of thousands of reservists, USERRA and other laws protecting returning military personnel are affecting many employers who sponsor qualified retirement plans.

ASPPA is a national organization of over 5,000 members who provide actuarial, consulting, administrative, legal, and other services to sponsors of qualified plans.

Many of the rights protected under USERRA relate to plans of the employer that are qualified under IRC §§401(a), 403(a), 403(b), 408(k), 408(p), and 457(b). ASPPA and its members believe that clarification and further guidance is required for certain aspects of the rules under IRC §414(u)(2)(i).

Summary of the Issues

This letter addresses a number of issues, which are described in greater detail below:

1. Year to which the make-up employee deferrals relate.

2. Required timing of employer contributions, whether they are discretionary profit sharing, QNEC, or matching.

3. Testing implications of a brief military leave.

Background

The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) protects the employment rights of individuals who perform military service. Generally, USERRA rights are available only to individuals who spend fewer than five years in the uniformed services. These rights are described in USERRA §4318.

For the period during which an employee is on military leave, an employer is required to make a contribution for an employee under a defined contribution plan, such as a profit sharing plan, provided that the employee returns to work for the employer within the time his or her employment rights are protected by law. The contribution is based on the compensation the employee would have received but for the period of military service during the applicable plan year(s) and the rate of contribution made for other employees during such period(s).

USERRA §4318(b)(2) and IRC §414(u)(2)(i) require that a plan participant have the right to make up §401(k) deferrals and after-tax employee contributions that he or she would have been able to make had it not been for the period of military service. This “make-up” is accomplished by permitting the participant to defer or contribute additional amounts after he or she returns to the plan sponsor’s employment. The time period for the employee to make up the contribution begins on the date of reemployment and ends on the earlier of five years or the last day of the period that is three times the period of military service. The participant is limited to any statutory or plan limit that was in effect for the plan year to which the contributions are attributable. In addition, the make-up limit for any year is adjusted by the amount of elective deferrals actually made during the period. If the plan is subject to ADP testing, these make-up contributions are not to be considered either in the year the contributions are actually made or the year to which the contributions relate.

When computing make-up contributions, the compensation is equal to the employee’s annualized rate of compensation at the time the leave commenced. If such an amount is not ascertainable, the employer determines compensation on the basis of the 12-month period immediately preceding the military leave or the actual period of service, if less. [See USERRA §§4318(b)(3)(A) and (B).]

The employer is required to make matching contributions on the make-up elective deferrals and after-tax employee contributions in that amount which would have been required had the employee made the deferrals or after-tax contributions while on military leave.

Employee and employer contributions are not considered in the make-up year when computing IRC §402(g) limitations on elective deferrals, IRC §415 limitations on annual additions and IRC §404(a) limitations on deductible contributions. Contributions are subject to these limitations for the plan year to which they relate.

In addition, employee and employer contributions are not considered in the make-up year, or in the year to which they relate, when making top-heavy determinations under IRC §416, or for purposes of nondiscrimination testing under IRC §401(a)(4), coverage testing under IRC §410(b) and nondiscrimination testing under IRC §401(k) and IRC §401(m).

Discussion of Issues

1. Does a participant who has qualifying military leave have the right to choose the year to which his or her make-up elective deferrals or after-tax contributions relate?

If a participant is in military service for a period that spans more than one plan year and the plan’s matching formula changes (either by amendment or a discretionary match that fluctuates), then it may be advantageous for the participant to select the plan year to which the make-up elective deferral or after-tax contribution is attributable. This same issue arises if the participant is eligible for more than one plan or wishes to take advantage of the catch-up contribution provisions under IRC §414(v).

Example #1

Joe is on active military service for the 2002 and 2003 plan years and his compensation is deemed to be $65,000 per year. The plan is a calendar year plan that limits deferrals to 8% of pay and has a dollar-for-dollar matching feature for deferrals up to 6% of pay.

As an active employee, Joe could have deferred $5,200 each year and would have received $3,900 in matching contributions in each year. However, if Joe could afford to contribute only $6,000 upon his return from military leave, he could maximize the amount of matching contributions to which he is entitled by designating $3,900 as the 2002 contribution and $2,100 as the 2003 contribution. If Joe is able to do so, the total matching contribution received will be $6,000. However, if it is determined that the first $5,200 (i.e., the maximum permissible amount) related to the 2002 year and the remaining $800 related to 2003, Joe would receive a match of only $4,700, thus losing $1,300 in matching contributions.

Example #2

Assume the same facts as Example #1 except that the plan has a discretionary match. The employer does not contribute any matching funds for the 2002 plan year. The employer makes a matching contribution for the 2003 plan year equal to 100% of elective deferrals up to 6% of compensation. If Joe only makes a make-up contribution of $6,000, and if the first $5,200 must relate to the 2002 plan year, then there will be no matching contribution associated with the 2002 make-up contributions. Joe would receive a match on the $800 that is associated with the 2003 plan year. However, if Joe is allowed to designate the year to which the make-up contribution applies, then he could designate the maximum permissible deferral for the 2003 plan year in order to maximize his match.

Example #3

Assume the same facts as Example #1 except that the plan offers no matching contributions. However, the plan sponsor has adopted the catch-up contribution provisions under IRC §414(v) effective for the 2003 plan year and Joe is over age 50. The plan limits elective deferrals to 6% of pay. Once again, if Joe is allowed to designate the year to which the make up contribution applies, it would be to his benefit to include all $6,000 for the 2003 plan year in order to take advantage of the catch-up provisions.

ASPPA Recommendation: Because USERRA (similar to other legislation regarding veteran's rights) is intended to favor individuals returning from military service, ASPPA proposes that returning participants be allowed to designate the plan year to which the make-up contributions apply without affecting the qualified status of the plan.

2. When is the employer make-up contribution required to be made?

ASPPA Recommendation: ASPPA proposes that employer contributions, other than matching contributions associated with make-up contributions made by a participant, be deposited up to the due date (including extensions) for the filing of the employer's tax return for the year in which a participant returns to work. ASPPA proposes that associated matching contributions be deposited by the due date (including extensions) for filing of the company's tax return for the year in which the participant's make-up elective deferrals or after-tax contributions are contributed to the plan by the participant.

3. Must the make-up contributions be disregarded or may the employer include them in testing?

IRC §414(u)(1)(C) states that a plan will not fail to meet the operational requirements of many Code sections as a result of a USERRA make-up contribution. This Code section implies that any make-up contributions not be taken into account for nondiscrimination testing in the year made. However, it is unclear how to perform the nondiscrimination testing if the make-up contribution is made during the same plan year to which the make-up contribution relates due to a very brief military leave.

ASPPA Recommendation: ASPPA suggests that the employer have the option to include any type of make-up contributions in the appropriate testing when a participant leaves and returns from military service within the same plan year. If an employer elects to include make-up contributions in a particular nondiscrimination test, then all make-up contributions of a similar source (e.g., all make-up elective deferrals) must be taken into account in such test.

Summary

ASPPA recommends that the Service clarify the obligations of plan sponsors regarding the application of USERRA so that qualified plans will be administered in compliance with USERRA and the Code.

This letter was prepared by ASPPA's 401(k) Subcommittee of the Government Affairs Committee. Please contact us if you have any comments or questions regarding the matters discussed above.

Sincerely,

Ilene H. Ferenczy, CPC, Chair Brian H. Graff, Esq.

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cc: Paul Shultz, Employee Plans Rulings
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