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July 30, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on the HEART Act Sections Addressed in IRS Notice 2010-15

Dear Commissioner Shulman:

Enclosed are comments on the HEART Act sections addressed in IRS Notice 2010-15. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Stuart M. Lewis".

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William Wilkins, Chief Counsel, Internal Revenue Service
J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, Department of the Treasury
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
George H. Bostick, Benefits Tax Counsel, Department of the Treasury
Alan N. Tawshunsky, Deputy Division Counsel/Deputy Associate Chief Counsel (Employee Benefits), Internal Revenue Service
William Evans, Attorney Advisor, Department of the Treasury

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**ABA SECTION OF TAXATION COMMENTS ON THE HEART ACT
SECTIONS
ADDRESSED IN IRS NOTICE 2010-15**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Matthew Eickman and Thomas Graves of the Employee Benefits Committee of the Section of Taxation. The Comments were reviewed by Mark A. Bodron, Vice Chair of the Employee Benefits Committee, and by Eleanor Banister, Chair of the Employee Benefits Committee. The Comments were further reviewed by Leonard S. Hirsh on behalf of the Committee on Government Submissions of the Section of Taxation and Thomas R. Hoecker, Council Director for the Employee Benefits Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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July 30, 2010

EXECUTIVE SUMMARY

These Comments are submitted in response to the request by the Internal Revenue Service (the “Service”) for public comments regarding the sections of the Heroes Earnings Assistance and Relief Tax Act of 2008 (the “HEART Act”)¹ addressed in Notice 2010-15 (the “Notice”).² We appreciate the Service’s efforts to provide interpretative guidance regarding the HEART Act. Further, we are grateful that the Service issued the Notice well in advance of the deadlines for amending plans to reflect the provisions of the HEART Act. There are, however, additional issues on which plan sponsors could use clarifying guidance. Our Comments, below, seek those clarifications.

Following is a summary of our recommendations with respect to the Notice:

1. We recommend that the Service issue additional guidance clarifying that: (a) a section 401(k),³ 403(b), or 457(b) plan’s reference to “severance from employment” is not considered to include a Deemed Severance (as defined in section A.1. of these Comments); and (b) if a plan sponsor desires to permit a distribution upon a Deemed Severance (as permitted under Q&A-12 of the Notice), the plan sponsor must amend its plan to recognize a Deemed Severance as a severance from employment. In addition, we recommend that the Service provide section 411(d)(6) relief to “early amender” plan sponsors to the extent such a plan sponsor would desire to remove Deemed Severance as a distribution event from its plan.
2. We recommend that the Service provide additional guidance that affords relief under section 411(d)(6) if a plan that defined compensation with reference to section 3401(a) is amended to exclude “differential wage payments,” along with relief from any advance notice requirements otherwise applicable under section 4980F and section 204(h) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), provided such amendment is adopted prior to the applicable deadline for adopting HEART Act amendments.

¹ Pub. L. No. 110-245, 122 Stat. 1624-1650.

² 2010-6 I.R.B. 390.

³ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

COMMENTS

A. DEEMED SEVERANCE FROM EMPLOYMENT

1. Summary

Section 105(b) of the HEART Act added a new section 414(u)(12), which relates to the treatment of differential wage payments and includes a special rule for distributions from certain account-based plans. That special rule provides that, notwithstanding the treatment of an individual receiving differential wage payments as an employee, “for purposes of section 401(k)(2)(B)(i)(I), 403(b)(7)(A)(ii), 403(b)(11)(A), or 457(b)(1)(A)(ii), an individual shall be treated as having been severed from employment during any period the individual is performing service in the uniformed services described in section 3401(h)(2)(A).”⁴ Thus, section 414(u)(12) generally provides that a section 401(k) plan, 403(b) plan, or 457(b) plan may permit a distribution upon a participant’s deemed “severance from employment” by reason of performing service in the uniformed services (a “Deemed Severance”). The Deemed Severance provision is effective for plan years beginning after December 31, 2008.

Q&A-12 of the Notice instructs that “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 section 414(u)(12)(B).” Q&A-12 of the Notice further provides that, 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.

2. Recommendation

We recommend that the Service issue additional guidance clarifying that: (a) a section 401(k), 403(b), or 457(b) plan’s reference to “severance from employment” is not considered to include a Deemed Severance; and (b) if a plan sponsor desires to permit a distribution upon a Deemed Severance (as permitted under Q&A-12 of the Notice), the plan sponsor must amend its plan to recognize a Deemed Severance as a severance from employment. In addition, we recommend that the Service provide section 411(d)(6) relief to “early amender” plan sponsors to the extent such a plan sponsor would desire to remove Deemed Severance as a distribution event from its plan.

3. Explanation

The plain language in section 414(u)(12)(B) does not clearly provide the same degree of flexibility afforded by the Notice in Q&A-12. Section 414(u)(12)(B)(i) provides, instead, that an individual “shall” be treated as having severed from employment for purposes of the section 401(k), 403(b), and 457(b) distribution restrictions if he or she has experienced a Deemed Severance. As a result, it was not apparent – prior to the Service’s issuance of the Notice – that a plan could allow distribution upon actual severance from employment but not a Deemed Severance. Many plan sponsors did not amend their plans prior to the effective date of the

⁴ I.R.C. § 414(u)(12)(B)(i).

Deemed Severance provision of the HEART Act, except perhaps to reflect the six-month deferral prohibition applicable in the event a distribution is received as a result of a Deemed Severance.⁵

It would be helpful if additional HEART Act guidance would clarify that a plan's reference to a "severance from employment" does not automatically include a Deemed Severance. As implied in Q&A-12 of the Notice, since the Deemed Severance distribution is optional, a plan should have to affirmatively provide for the Deemed Severance in order to provide for the distribution option under section 414(u)(12)(B). This would be consistent with the normal plan document design to expressly set forth all permissible distribution events and options under the plan (along with other plan terms).

Moreover, if the phrase "severance from employment" is considered to automatically include a Deemed Severance, then many plan sponsors will be unable to take advantage of the permissible interpretation provided by the Notice with respect to benefits already accrued. As a result, plan sponsors would be forced to either (i) assume the administrative burden required to ensure that only amounts that accrued prior to amendment of the plan's severance from employment provision are available for distribution upon a Deemed Severance or (ii) forego the Notice's flexibility altogether (by not carving out Deemed Severances).

Finally, there are plan sponsors that amended their plans prior to the issuance of the Notice to expressly provide for the Deemed Severance distribution event because they read section 414(u)(12)(B) as a mandatory distribution option. With respect to these "early amender" plan sponsors, to the extent such a plan sponsor would desire to remove the Deemed Severance distribution event in light of the Q&A-12 of the Notice 2010, we believe it would be helpful and reasonable to provide guidance that would permit the plan to be amended to remove the Deemed Severance distribution event during the remedial amendment period for the HEART Act and such plan will be deemed to be in operational compliance despite the fact that it may have allowed the Deemed Severance distributions during such period.⁶ Further, we request that the Service exercise its authority under section 411(d)(6)(B) and Treasury Regulation section 1.411(d)-4, Q&A-2(b) to relax the application of section 411(d)(6) in this context.

⁵ I.R.C. § 414(u)(12)(B)(ii).

⁶ This approach would be similar to that taken by the Service with respect to the waiver of 2009 required minimum distributions under section 201 of the Worker, Retiree and Employer Recovery Act of 2008 in Notice 2009-82, 2009-41 I.R.B. 491.

B. DIFFERENTIAL WAGE PAYMENTS

1. Summary

Section 105(a) of the HEART Act added a new section 3401(h), which treats a “differential wage payment” (as defined by section 3401(h)(2)(A)) as a payment of wages by the employer to the employee for purpose of section 3401(a). This change applies to differential wages paid after December 31, 2008. Under section 414(u)(12)(A), as added by HEART Act section 105(b)(2)(A), a differential wage payment shall be treated as compensation for purposes of applying the Code to retirement plans.⁷ Q&A-9 of the Notice clarifies, however, that differential wage payments are not required to be treated as compensation for purposes of determining contributions and benefits under a plan.

2. Recommendation

We recommend that the Service provide additional guidance that affords relief under section 411(d)(6) if a plan that defined compensation with reference to section 3401(a) is amended to exclude “differential wage payments,” along with relief from any advance notice requirements otherwise applicable under section 4980F and section 204(h) of ERISA, provided such amendment is adopted prior to the applicable deadline for adopting HEART Act amendments.

3. Explanation

Plan sponsors may have various reasons for not including differential wage payments for purposes of benefit accruals and calculations. For example, in a final average pay defined benefit plan, the inclusion of differential wages may result in a decreased benefit in certain cases. Additionally, the inclusion of differential wage payments – which in and of itself would already represent an expense for the plan sponsor – could increase a plan sponsor’s costs of maintaining the plan. Consistent with those motivations, plan sponsors may have decided to not include differential wage payments received on or after January 1, 2009, for benefit and contribution purposes. The Notice clarifies that such a decision would have been permissible.

The Notice does not, however, address the ability to adopt a plan amendment excluding differential wage payments from the definition of compensation for contribution and benefit accrual purposes on or after the effective date of section 3401(h). Many plans define compensation by reference to section 3401(a). Without express guidance to the contrary, a plan sponsor that wishes to utilize the permissive exclusion described in the Notice could be impermissibly cutting back a benefit accrual if it were to amend its plan after the effective date of section 3401(h). Moreover, the inability to amend a plan’s compensation definition to exclude differential wage payments might provide a disincentive to a plan sponsor that desires to provide the additional benefit accruals that are optional under section 414(u)(9). This could be the case in a defined benefit plan with a final average pay formula if the inclusion of differential pay would result in a participant’s final average pay decreasing and, as a result, a reduction in the benefit payable to the participant. This scenario highlights the possibility that a plan amendment

⁷ I.R.C. § 414(u)(2)(A).

might operate to the favor of some participants, but serve as an impermissible cutback with respect to other participants.

Accordingly, we recommend that the Service exercise its authority under section 411(d)(6)(B) and Treasury Regulation section 1.411(d)-4, Q&A-2(b), as described earlier in Section A.3. of these Comments, to relax the application of 411(d)(6) in this context. We recognize that section 411(d)(6) relief for retroactive amendments should not be available on an indefinite basis, but submit that plan sponsors should have that relief available until at least the end of the HEART Act remedial amendment period. In addition, we request that the Service's guidance provide relief under section 4980F and ERISA section 204(h) for amendments adopted prior to the end of the HEART Act remedial amendment period.⁸

⁸ The Secretary of the Treasury has interpretive authority over section 204(h) of ERISA pursuant to section 101(a) of Reorganization Plan No. 4 of 1978, 29 U.S.C. § 1001.