

## **MOBILIZATION ISSUES THAT EFFECT YOU AND YOUR EMPLOYER**

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Despite the language contained in both the Uniformed Services Employment and Reemployment Rights Act (USERRA) and the Servicemembers Civil Relief Act (SCRA) many Reservists and National Guard member's questions go unanswered. This article is intended to answer many of the mobilization and post deployment issues that have affected our men and women performing active duty military service over the last two years.

### **TAXES**

The Internal Revenue Service (IRS), contrary to 38 U.S.C. 4316(b)(1)(A), is of the position pursuant to Revenue Ruling 69-136 that the employer-employee relationship is terminated when the employee reports for active duty military service (Army, Navy, Air Force or state National Guard). It is important to understand that Section 4316(b)(1)(A) provides that "a person who is absent from a position of employment by reason of service in the uniformed services ... shall be deemed to be on furlough or leave of absence *while performing such service*." In accordance with the 1969 Revenue Ruling, payments made by the employer to employee, while they are on military service, are not classified as "wages" for services performed in "employment" for the employer. The payments are therefore not subject to taxes imposed by the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA) or to the collection of income tax at source on wages.

#### Differential Pay:

The payments are defined as "payments made voluntarily by an employer to represent the difference between the employees' regular salary and the amount being paid to them by the military, if the regular salary is higher." They consist of the following: military continuation pay; active duty differential payments required by state statutes or payments made by certain states or commonwealths who pay a stipend for a set dollar amount to their employees called to military active duty.

The IRS has taken the following position on differential pay: (i) employers should report it on Form 1099 MISC, Box 3: Other Income; (ii) FICA and income tax should not be withheld from the payments; and (iii) the payments are not subject to FUTA. The employee should treat the payments as follows: (i) report them on Line 21 of Form 1040 as Other Income, Military Differential pay; (ii) no self-employment tax will be owed on the payments because the income is not derived from any trade or business conducted by the employee for self-employment tax purposes; and (iii) make quarterly estimated tax payments in order to avoid a year-end tax liability on the income.

#### Paid Leave:

If you utilize paid leave (vacation, sick or accrued time) for your military leave, under 5 U.S.C. 6323 the compensation will be taxed as civilian pay and subject to income tax and withholding. USERRA gives you the right, but not the obligation, to use and be paid for such annual leave.

#### Erroneous Withholding:

If FICA and income taxes are erroneously withheld by an employer, they can correct the error on Form 941 by making an adjustment for the quarter during which the error was discovered. The employer will file a Form 941C, Supporting Statement to Correct Information, when making the adjustment. Alternatively, if excess FICA was paid in a prior period, you can also recover the excess amount by filing a claim for refund using Form 843, Claim for Refund and Request for Abatement, and Form 941C. The reimbursement of erroneously withheld FICA taxes will also entitle the employer, who paid a portion of FICA, to a refund.

If the employer refuses to seek a refund on the employee's behalf, the employee may file a claim for refund using Form 843 (Claim for Refund and Request for Abatement). On Line 5 the employee will need to explain why they are due the refund and all efforts made to secure it. The refund request must include a statement from the employer indicating whether the employer has reimbursed any of the erroneously withheld FICA to the employee or filed a claim for refund of any of the erroneously withheld FICA. Alternatively, the erroneously withheld funds will serve as a credit on your personal tax return.

#### Withholding (by Agreement):

In order for the service member to avoid a year-end tax liability on their differential pay, they may enter into a voluntary tax withholding agreement with their employer. The agreement will allow the employer to withhold taxes on the income being paid to the service member. It is highly recommended that every service member receiving differential pay pursue this option if available through their employer.

#### Combat Zone Pay:

Compensation received for active service in a combat zone is excludable from gross income. This exclusion applies only to compensation paid by the military to service members. Compensation paid by other employers (private enterprises or governmental entities) to service members is not excludable as combat zone compensation regardless of where the recipient is performing active military service at the time the payment is made.

#### Residency:

For tax purposes, SCRA Section 571 provides that a nonresident service member's military income and personal property are not subject to state taxation if the service

member is only present in the state due to military orders. A state is also prohibited from using the service member's military pay to increase the state income tax on their spouse's income.

## **RETIREMENT ACCOUNTS**

USERRA (38 U.S.C. § 4318(a)(2)(B)) requires employers to treat the service member's period of military leave as service with the employer for purposes of vesting and the accrual of benefits. The period of military leave will not be treated as a break in service under the plan. A rehired service member must also be permitted to make up missed contributions required to earn a benefit accrual for the military service period. If employee contributions are required or permitted under the plan, the employee will have a period equal to three times the period of military duty or five years, whichever ends first, to make up the contributions.

### Pension Benefits:

Upon reemployment, the employer will be required to make any employer contributions that would have been required, on behalf of the returning employee, had they continued working for the employer during the period of service. The returning service member must also be allowed to make up any employee contributions or elective deferrals they would have been eligible to make during the period of service. The amount of make-up contributions is subject to the limits that applied during the period of military service.

### 401(k) Plan (Employer and Employee contributions):

Service members, while serving on active military duty, may not make contributions to their employer 401(k) plan. The IRS, as stated above, views the employer-employee relationship terminated when the employee reports for active military service. Any employee payments made while on active duty, either with personal funds or differential pay, would be in violation of the employer plan.

While on active duty there is no requirement for an employer to make contributions to your 401(k) plan. Upon your return and reemployment the employer must make employer contributions that would have been made if you had been employed during the period of military duty. If the employee makes up the contributions, the employer must make up any matching contributions.

### Make-up Contributions:

Under USERRA, the employer does not have to begin the make-up contributions until after the service member returns to their civilian employment (same employer). The employer's make-up contribution period is equal to that on the employee (referenced above). If the employer contributions are contingent on the employee's elective contributions, that are made, the employer will be required to make up its contributions over the same period that the service member uses. If the make-up contributions cover

several years the employee can designate the specific year or years their contributions cover.

The make-up contributions, if they span several years, should be reported beginning with the earliest year on the employees W-2 in Box 12 as a "Code D" with year and amount. The reporting of make-up non-elective contributions, voluntary after-tax contributions, required employee contributions and employer matching contributions, should be in box 14 with each amount separately listed for each year.

#### Lump Sum Make-Up Payment:

The IRS is of the opinion that an employee that returns to work with their employer can make a lump sum make-up contribution payment assuming the employers plan permits such a payment. The payment would be an after-tax employee contribution and not excluded from income. However, elective deferrals from your compensation would be excluded from income.

#### Thrift Savings Plan (TSP):

Employees who are covered by FERS and CSRS, as well as members of the military may participate in the Thrift Savings Plan (TSP). Employees that participate in the TSP as both Federal employees and service members must pay attention to the annual Internal Revenue Code contributions limits.

### **DISABILITY**

USERRA (38 U.S.C. 4313(a)(3)) requires an employer to make "reasonable efforts" to accommodate service members with a disability (permanent or temporary) incurred or aggravated during military service. If a member returns from military service with a disability that cannot be accommodated by reasonable employer efforts, the employer is required to reemploy the member in another position he or she is qualified to perform and which is the "nearest approximation" of the position to which the member is otherwise entitled (status and pay) with full seniority.

### **HEALTH CARE BENEFITS**

USERRA (Section §4317(a)(1)) requires employers to allow any employee on a military leave to elect and pay, for up to 18 months, for continuation of coverage for them self and dependents under any health care plan. The service member may be required to pay up to 102% (employer's share, employee share, and 2% for administrative costs) of the full premium associated with the coverage. Upon the members return to employment (same employer) the employee will not be subject to any waiting period or preexisting condition exclusions upon reinstatement (38 USC §4317(a)(1)).

#### Flexible Spending Accounts:

A flexible spending account (FSA) is a type of cafeteria plan, under Section 125 of the Internal Revenue Code (the "Code"), which allows employees to contribute pre-tax funds for expenditure on medical and dental benefits. The employee will be reimbursed, up to the amount committed from gross pay, for expenses covered by the FSA. The employer must also make available to the employee the full amount of the benefit whenever the reimbursable expense occurs. Any funds remaining in the employee's account, at plan year end, become the property of the employer.

If you are called to military service, during a plan year, it will constitute a leave of absence and equate to a "change in status" for purposes of your plan elections. Any contributed funds remaining in your account will be available to you until the plan year end. However, there is currently no statutory exception to the requirement that application for qualified reimbursable costs be made on a timely fashion (plan requirements).

#### Employer Provided Health Care Benefits:

The service member's gross income will not include employer-provided coverage under an accident or health plan. This exclusion will apply during both the term of their employment and while they are serving on military duty.

#### Group Term Life Insurance:

The cost of up to \$50,000 of group term life insurance coverage will not be included in the service member's gross income while they are employed or on military leave.