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Mobilization Issues That Affect 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 mobilized National Guard and Reserve members have questions that go unanswered. This article is intended to answer many questions that have been brought to my attention about mobilization and post-deployment issues that have affected our men and women performing active duty military service over the last two years.

TAXES

USERRA does not require your employer to make up the difference between your military pay and your civilian pay, if the military pay is less, but many employers make this accommodation voluntarily. Way back in 1969, the Internal Revenue Service (IRS) took the position (Revenue Ruling 69-136) that the employer-employee relationship is terminated when the employee reports for active duty military service. Payments made by the employer to employee, while the employee is on active duty, 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 the source on wages.

Of course, the fact that these payments are not subject to income tax withholding does not mean that you are exempt from the obligation to pay tax on them. If income tax is not withheld when the differential is paid, you must report the payment and pay tax later. Your responsibility to report and pay income tax applies to all taxable income that you receive, which includes self-employment income and other income, as well as salary or wages. On the other hand, Social Security, Medicare, and unemployment compensation taxes only apply to salary and wages.

I am of the opinion that the basic premise of Revenue Ruling 69-136 is contrary to section 4316(b) of USERRA. That section 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." [38 U.S.C. 4316(b)(1)(A) (emphasis supplied)]. Thus, the person who is away from work performing uniformed service should be considered a current employee on a military leave of absence-the employment relationship has not been terminated. It should be noted that the IRS promulgated this Revenue Ruling 25 years before USERRA was enacted in 1994. USERRA was a complete rewrite of and replacement for the Veterans' Reemployment Rights (VRR) law, which can be traced back to 1940.

The wording of the VRR law was different in a significant way: "Any person who is restored to or employed in a position in accordance with the provisions of clause (A) or (B) of subsection (a) of this section shall be considered as having been on furlough or leave of absence during such

person's period of training and service in the Armed Forces.” [38 U.S.C. 2021(b)(1)(A) (1988 edition of the U.S. Code) (emphasis supplied)]. The IRS needs to reconsider Revenue Ruling 69-136 in light of the 1994 enactment of USERRA, but there is no immediate prospect of that occurring.

Differential Pay

These 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.” The payments consist of the following: military continuation pay; active duty differential payments required by state statutes; or payments made by certain states or commonwealths that pay a stipend or 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.

Erroneous Withholding

If an employer erroneously withholds FICA and income taxes, the employer can correct the error by using Form 941 to make 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

Alternatively, 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, you (the employee) will need to explain why you are due the refund and all efforts you have 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.

Withholding (by Agreement)

In order for the servicemember to avoid a year-end tax liability on the differential pay, the member may enter into a voluntary tax-withholding agreement with the 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 servicemember receiving differential pay pursue this option if

available through the 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.

RETIREMENT ACCOUNTS

USERRA requires employers to treat the servicemember'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 also not be treated as a break in service under the plan. A rehired servicemember 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 re-employment, the employer will be required to make any employer contributions that would have been required on behalf of the returning employee had he or she continued working for the employer during the period of service. The returning servicemember must also be allowed to make up any employee contributions or elective deferrals he or she 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)

A servicemember, while serving on active military duty, may not make contributions to the employer's 401(k) plan. The IRS, as stated above, views the employer-employee relationship as having been 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 you are on active duty, the employer is not required to make contributions to your 401(k) plan. Upon your return and re-employment, the employer must make employer contributions that it would have made if you had been employed during the period of military duty. If the employee makes up the employee 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

servicemember returns to his/her civilian employment (same employer). The employer's make-up contribution period is equal to that on the employee (previously referenced). 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 servicemember uses. If the make-up contributions cover several years, the employee can designate the specific year or years the contributions cover.

The make-up contributions, if they span several years, should be reported beginning with the earliest year on the employee's 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 a lump sum make-up contribution payment could be made, assuming the 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 who participate in the TSP as both federal employees and servicemembers must pay attention to the annual Internal Revenue Code contributions limits.

Disability

USERRA requires an employer to make "reasonable efforts" to accommodate the circumstances of a returning servicemember 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 re-employ 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 requires an employer to allow an employee on a military leave to elect and pay, for up to 24 months, for continuation of coverage for the employee and dependents under any health-care plan. The servicemember may be required to pay up to 102 percent (employer's share, employee share, and 2 percent for administrative costs) of the full premium associated with the coverage. Upon the member's return to employment (same employer), the returning employee is entitled to immediate reinstatement of the health-plan coverage. There must be no waiting period and no exclusion of pre-existing conditions, unless those conditions have been determined to be service connected by the secretary of Veterans Affairs.

Flexible Spending Accounts

A flexible spending account (FSA) is a type of cafeteria plan, under Section 125 of the Internal Revenue Code, that 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 servicemember's gross income will not include employer-provided coverage under an accident or health plan. This exclusion will apply during both the term of the person's employment and while he or she is 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 servicemember's gross income while he or she is employed or on military leave.

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* Military title used for purposes of identification only. The views expressed herein are the personal views of the authors and should not be attributed to the U.S. Marine Corps, the Department of the Navy, the Department of Defense, or the U.S. government.

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