Morgan Lewis

2020 TECHNOLOGY MAY-RATHON: MISSION CRITICAL BENEFITS IN A PANDEMIC ECONOMY

Handy Hevener, Randy Tracht, David Zelikoff, Sage Fattahian, and Elizabeth Goldberg

May 27, 2020

© 2020 Morgan, Lewis & Bockius LLP

Agenda

- Retirement Plan Issues Under the CARES Act | Randy Tracht
- Executive Compensation Considerations | David Zelikoff
- Extended ERISA Deadlines, Permitted Election Changes, and Extended Claims Periods | Sage Fattahian
- Six Considerations for Plan Fiduciaries During the COVID-19 Pandemic | Elizabeth Goldberg
- Fringe Benefit and Payroll Tax Issues | Handy Hevener

RETIREMENT PLAN ISSUES

CARES Act Retirement Plan Features

The CARES Act Impacts 401(k) retirement plans:

- **Access to Savings**
Provides employees with more opportunities to immediately access retirement savings

- **Delay Impact**
Temporarily delay the financial consequences of certain retirement plan features

- **It's optional!**
Employers can choose to adopt (or not) all or any portion of the features offered by the CARES Act

Key features of the CARES Act that 401(k):

- **Coronavirus Distributions**
For 2020, distributions of up to $100,000 that qualify for favorable tax treatment (no 10% early withdrawal penalty and taxed ratably over three years) and can be repaid

- **Coronavirus Loans**
Until September 22, 2020, increased plan loans from existing limit of lesser of $50,000 and 50% of account to lesser of $100,000 or 100% of account

- **Coronavirus Loan Suspension**
Extended due date for plan loan repayments due between the date of enactment and December 31, 2020

IMPORTANT! CARES Act features only available to "Qualified Individuals" :

- Person who is diagnosed, or whose spouse or dependent is diagnosed, with COVID-19 using a CDC-approved test; or
- Person who experiences adverse financial consequences because of an inability to work due to quarantine, furlough, layoff, reduced hours, loss of child care, or the closing or reduction of hours of a business owned or operated by the individual because of COVID-19
- ***Plan administrators can rely on individual's self-certification***

Hardship Withdrawals (not CARES Act)

401(k) accounts can permit hardship withdrawals expenses/losses stemming from a federal disaster: "provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for *individual assistance* with respect to the disaster."

COVID-19 pandemic declared a nationwide disaster, but FEMA has not designated all states as eligible for "individual assistance"
FEMA has declared many hard-hit states (New York, Washington, California, Massachusetts, etc.) as eligible for individual assistance, but declarations not uniform for all states

Lingering uncertainty about whether the individual assistance designated by FEMA (FEMA's individual "Crisis Counseling Program") qualifies for these purposes – although FEMA's program and policy guide clearly characterize Crisis Counseling as individual assistance

Suspension of Retirement Plan Contributions

Many employers are considering the temporary suspension of employer-provided retirement plan contributions

In many instances, ongoing and periodic employer contributions can be suspended prospectively with nothing more than a plan amendment

However, suspending contributions in a so-called “safe harbor” 401(k) plan raises special issues and considerations

Other types of annual employer contributions that are contingent upon satisfying certain conditions may raise special issues and considerations

EXECUTIVE COMPENSATION
CONSIDERATIONS

Base Salary

Reductions

Temporary reduction of base salary

Deferrals

Deferral of a portion of base salary to a later tax year

Equity exchange

Exchange stock for base salary

Annual Bonus/Long-Term Incentive Bonus

Setting performance goals

If performance goals have not been set, can typical performance goals be adjusted to take into account the pandemic's impact on the business?

Adjusting existing performance goals

Can existing performance goals be adjusted in light of the pandemic, with adjustments to performance metrics or changes to applicable goals?

Deferring payment

Can bonus payment be deferred to a later tax year?

STOCK OPTIONS

- Timing of grants
- Valuation
- Repricing
- Modifications

RESTRICTED STOCK

- Timing of grants
- Changes to vesting period
- Section 83(b) elections

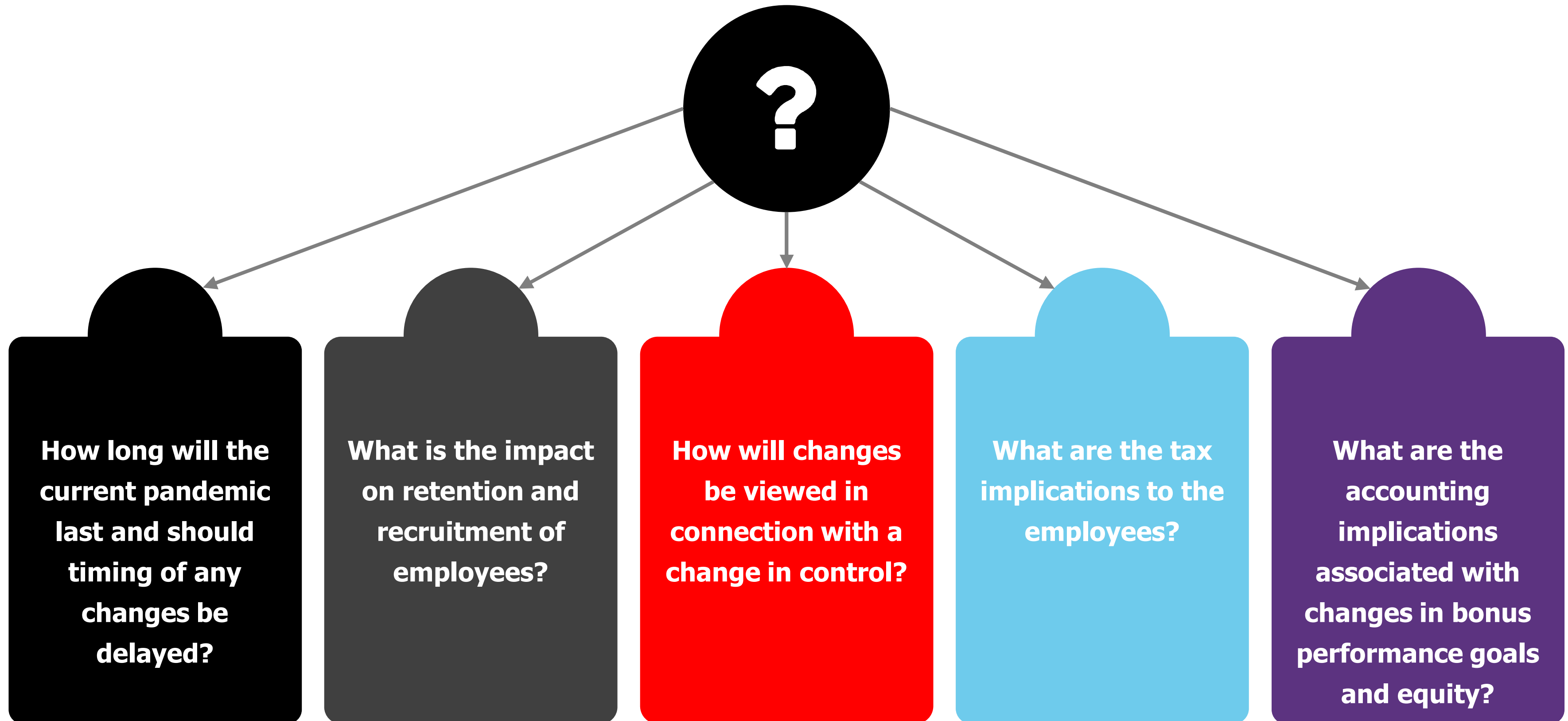
RESTRICTED STOCK UNITS

- Timing of grants
- Changes to conversion date
- Deferral of delivery of shares

Employment/Severance Agreements

Change to Employment Terms	Any reductions in compensation (base salary, bonus, equity) may conflict with terms of existing agreements with employees
Severance Arrangements	The impact on changes in compensation will need to be taken into account in connection with any terminations while change is in effect

Additional Considerations



EXTENDED ERISA DEADLINES, PERMITTED ELECTION CHANGES, AND EXTENDED CLAIMS PERIODS

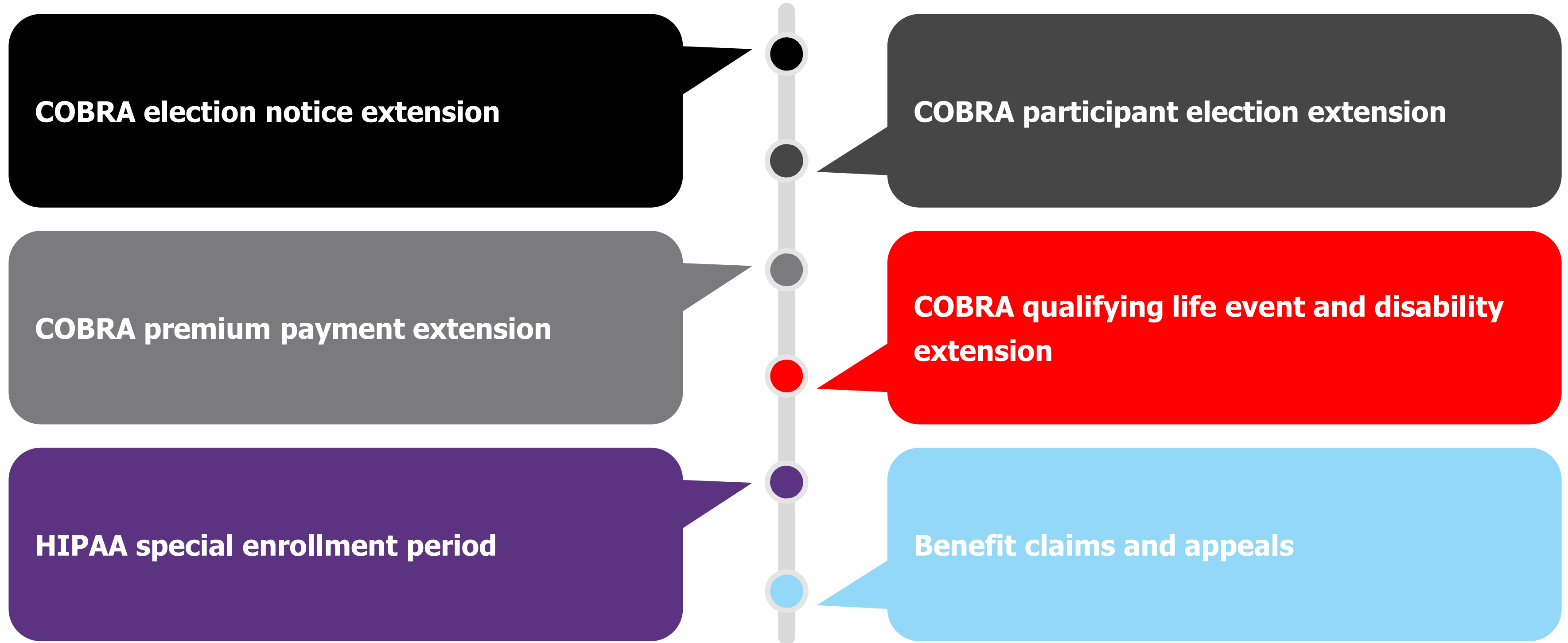
EBSA Disaster Relief Notice 2020-01

- Relates to notifications required under Title I of ERISA
  - Summary plan descriptions, summary of material modifications, summary benefits of coverage, SAR, etc.
- Applies to notices required between March 1, 2020 through 60 days after the end of the period of national emergency
- Deadlines to provide notices extended
  - Act in good faith, which includes the use of electronic communications
  - Provide notices as soon as administratively practicable under the circumstances

Extension of Certain Timeframes

- Applies to ERISA-governed welfare plans
- Extension applies through 60 days after the end of the period of national emergency – "outbreak period"
- Existing plan administration does not change
- No communication or plan amendment requirements

Extension of Certain Timeframes



Cafeteria Plan Elections

- Permits **prospective** mid-year election changes for employer-sponsored health coverage, HFSAs and DCFSAs
- Practically, a midyear open-enrollment opportunity
  - Make a new election
  - Revoke an existing election for other employer coverage or different coverage (with attestation)
  - Stop an HFSA or a DCFSA, make a new election, decrease or increase an existing election
- Doesn’t require any event or other criteria
- Permissible to offer—but not required

Elections Under Cafeteria Plans

- Not required to provide unlimited election changes
- Can provide a limited timeframe to take advantage of relief
- HFSA election to reduce contributions can be limited to the amount already reimbursed
- Amend plan documents to reflect changes by December 31, 2021

Practical implications

All changes are prospective; this means no refunds from spending accounts permitted

Gives eligible employees who declined coverage a second chance to elect employer group health plan coverage

Extended Claims Periods for Health FSA and Dependent Care FSA

- Permits unused amounts remaining in a calendar-year HFSA and DCFSA as of the end of a 2019 grace period (or 2019 HFSA $550 carryover) or a plan year ending in 2020 to extend the timeframe to incur claims through December 31, 2020
- Must amend plan document by December 31, 2021

High-Deductible Health Plans (HDHPs)

- HDHPs can offer medical care services related to testing and treatment of COVID-19 prior to satisfaction of deductible at no cost-sharing or reduced cost-sharing back to January 1, 2020 without jeopardizing HSA eligibility
- HDHPs can offer telehealth services related to testing and treatment of COVID-19 at no cost-sharing or reduced cost-sharing prior to satisfaction of deductible back to January 1, 2020 without jeopardizing HSA eligibility

Practical implications

Solve problems created by vendors who jumped the gun

Could potentially reajudicate claims back to January 1, 2020

Remains to be seen whether this becomes permanent

Health FSA Carryover

- Increases carryover feature in an HFSA to $550
- Amendment must be adopted by December 31, 2021

SIX CONSIDERATIONS FOR
PLAN FIDUCIARIES DURING
COVID-19 PANDEMIC

ERISA Fiduciary Duties During the COVID-19 Pandemic

- ERISA's fiduciary duties require benefit plan fiduciaries to act with "care, skill, prudence and diligence under the circumstances then prevailing."
  - Under this legal standard, the prevailing facts and circumstances may inform the appropriate course of action.
- In 2020, the relevant facts and circumstances include the COVID-19 global health pandemic and the related economic instability, and ERISA plan fiduciaries may need to calibrate their processes and decisions to fit the pandemic environment.
  - In fact, ERISA's emphasis on giving consideration to such prevailing circumstances (and engaging in the appropriate process in light of those circumstances) is arguably heightened in times of social and financial turmoil.
  - Fiduciary decisions made during this difficult time may be especially ripe for second-guessing by plan participants or by regulators.

ERISA Fiduciary Duties During the COVID-19 Pandemic (cont.)

- ERISA fiduciaries may want to identify steps they could be taking, and decisions they could be considering, to adjust their process in the face of the COVID-19 pandemic.
- In taking these steps, fiduciaries should take care to <u>document</u>, <u>document</u>, <u>document</u> their actions in order to preserve a helpful record of the due diligence.

Six Considerations

1. Discuss Preparedness with Investment Managers and Investment Consultant

2. Review—and then Closely Watch—Plan Investments

3. For Defined Contribution Plans, Consider Investment Preservation Options

4. Increase Participant Education

5. Review and Adjust the Committee Process

6. Evaluate the Plan's Fraud Protection Mechanisms

1. Discuss Preparedness with Investment Managers and Investment Consultants

Service Provider Check-In

This is a good time for ERISA plan fiduciaries to reach out to service providers (such as investment managers and consultants) to check in on the provider's ability to handle—and adjust to—economic and societal disruption.

Consider questions about:

- Business continuity plans
- Capacity to handle operational disruption
- Investment continuity
- Possible delays in reporting
- The role of key personnel and backup plans should a key person become unavailable

Goal of Confirming Operational Viability

The goal of this inquiry could be to confirm (and document that confirmation) that the provider appears able to continue to operate—or adjust—to future economic and societal disruptions, so that the plan is able to continue investment-related operations.

2. Review—and then Closely Watch—Plan Investments

Emphasize Investment Reviews

During this time of uncertainty, it may be even more appropriate for ERISA fiduciaries to review the plan's investments and fund lineup (in the case of a defined contribution plan) to consider whether they remain prudent.

Consider Reviews, for example:

- Rebalancing
- Liquidity
- Readiness of investments for volatility (for example, whether the prospect of future market volatility warrants adjustments)
- Employer stock monitoring

Consider More Frequent Oversight

Also, if the investment review raises concerns, fiduciaries should explore appropriate adjustments (and, again, document those adjustments).

3. Consider Investment Preservation Options (for DC Plans)

Importance of Investment Preservation Options

Some DC participants—especially those nearing retirement—may have investment needs focused on preserving investment value. Market disruptions can have an outsized effect on those participants.

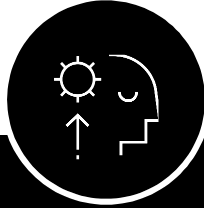
Consider Investment Preservation Options

Fiduciaries may wish to engage with their consultants and other advisers to evaluate whether the investment options on the more conservative end of the lineup offer sufficient income preservation opportunities.

Confirm Options are Designed to Retain Value

If the plan offers such options, another due diligence step could be to review those options—with the manager and/or investment consultant—to consider whether those options are, in fact, performing as they should (to preserve value).

4. Increase Participant Education (Especially for DC Plans)



Now May Be a Time for Participant Education

In the face of market challenges, it may be wise to increase participant education efforts, particularly for defined contribution plans.

Value of Education

If the markets continue to experience volatility, both the plan participants and the plan fiduciaries will benefit from an increased focus on educating participants to empower them to make decisions that best suit their investment and retirement goals.

Consider the Following:

- More frequent education sessions, including undertaking virtual participant education sessions (to fit remote work environment).
- On income preservation options, education on both the benefits (especially for those nearing retirement) and also the risks.
- For long-term needs, explore hiring a third-party education provider and/or implementing a participant advice service.

5. Review and Adjust the Committee Process

Committees Should Not Lose Focus on Appropriate Procedures

Instead, during COVID-19 period, committees may need to adjust their processes to ensure they can continue to function and engage in an appropriate level of oversight of the plan in a virtual and "work from home" environment.

For example:

- Rather than forgoing meetings altogether because of remote work environments, committees should consider moving to virtual or telephonic meetings.

- Some committees may find that more frequent meetings are necessary during this time of disruption and volatility.

Consider Committee Rules

These types of process changes may require amendments to the committee's governing documents (i.e., charter or by-laws) and so now might be a good time to review those documents and rules, and to make any updates to fit the COVID-19 world.

6. Evaluate the Plan's Fraud Protection Mechanisms

The COVID-19 Crisis May Trigger Increased Fraud Activities

There may be increased fraud risks due to economic disruptions and increases in electronic communications.

Benefit plans can be a prime source for fraud, given the data and assets held by such plans.

Risks include both identity theft and fraudulent benefit payouts.

Fraud May Raise Fiduciary Duty Concerns

The ERISA fiduciary duties of loyalty and prudence could be deemed to impose an obligation to take reasonable steps to shield participants from losses stemming from benefit plan fraud.

Consider a Review of Plan's Fraud Protection Structures, for example:

- Inquire with the plan's service providers (such as the plan's recordkeeper) on fraud protection mechanisms.

- Conduct a formal audit to evaluate how participant information is protected.

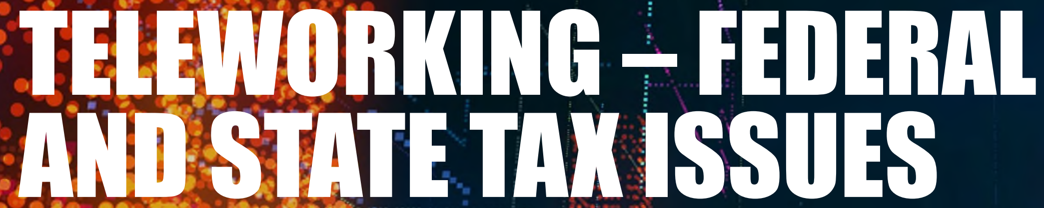
Other Considerations as the COVID-19 Crisis Continues

- In taking these steps, the fiduciaries should carefully document their actions to preserve a record of their due diligence.
  - Just as having a prudent process is key to satisfying ERISA's fiduciary standard, a ready record of that process is key to proving compliance with that standard, especially in later litigation and government inquiries.
- Other considerations are likely to materialize as the pandemic and related economic fallout continue to evolve.
  - So fiduciaries should be aware of the need to continue to make adjustments where necessary.

FRINGE BENEFIT AND
PAYROLL TAX ISSUES

Overview

- Teleworking – Federal and State Tax Issues
- CARES Act
  - 6.2% Payroll Tax Deferral
  - Employee Retention Credit


TELEWORKING – FEDERAL
AND STATE TAX ISSUES

Potential for abuse

Employees may claim to be working when they are not

Reimbursement issues

State reimbursement laws related to cell phone and internet usage expenses related to required business-related work

Strain on IT systems

- Telework infrastructure and/or policies not fully implemented or updated for telework
- Information security and confidentiality concerns

Foreign nationals

- Unique concerns for foreign nationals working in the US on work-related visas
- Case-by-case analysis

Time-recording issues

- Time worked may not be accurately tracked
- Potential liability for “off-the-clock” work, meal and rest break violations, and similar claims

Employee morale

Diminished connectivity and loss of productivity

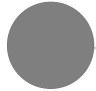
Teleworking Federal Tax Issues – Business Expenses

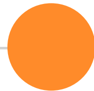
- "Shelter in Place" orders across the US (particularly in California, Illinois, and other states mandating reimbursement for employee business expenses) resulted in employers needing to expand (or design) policies providing or reimbursing cell phones, home internet, and other employee business expenses
  - Reimbursement proposals ranged initially from $100 to $65,000
  - Substantiation needed to qualify for the "working condition exclusion" for benefits provided in kind or by reimbursement
  - Expenses that are not substantiated or that trigger section 162 deduction limitations (e.g., "stay over a year in one location") would be taxable, unless § 139 applies
  - Congress's removal of cell phones and (per the TCJA) computers from "listed property" ameliorates but does not eliminate at least some substantiation for these types of benefits

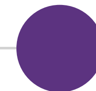
State Tax Withholding and Reporting

- Employers are wrestling with whether to change state income tax withholding (and whether changes are allowed) for employees who are working in locations other than the regular work locations
  - There are different scenarios that vary depending on whether the regular work state and telework state have income taxes, reciprocity rules, or "convenience of employer" rules (discussed on next slide)
  - Employers that may not be registered to do business in the telework state may resist having to start filing in those states
    - Relief requests have been submitted to Congress, but there has been no action
    - Different states have been issuing guidance

Scenarios



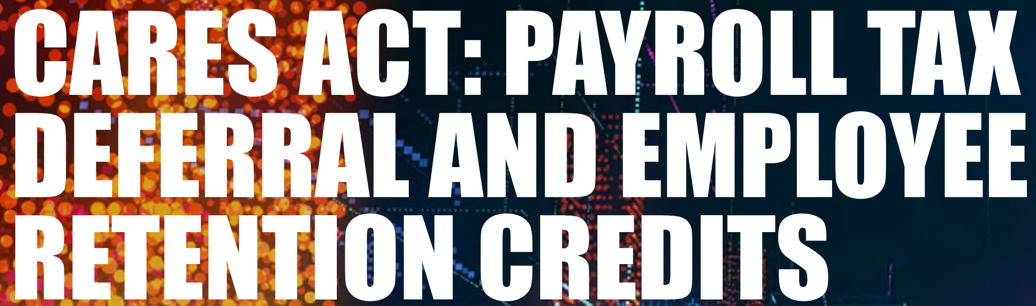




No Reciprocity
Assumes that the primary office state and telework state do not have reciprocity and are not "convenience of the employer" states. In many instances, the employer would adjust withholding from the primary office state to the telework state, particularly where the telework state imposes state taxes on an employee temporarily working in that state.

Reciprocity
Employee teleworks from a state that has reciprocity with their primary office state. Employer would continue to withhold on the employee in the resident telework state (assuming the employer has collected a nonresident withholding certificate from the employee).

Convenience of the Employer/Telecommuter
Employee works from home in a state that is different from his or her primary work location, which is located in a jurisdiction that imposes the "convenience of the employer" rule for withholding (i.e., NY, DE, NE, PA, CT). Employer would presumably still withhold on the employee in the primary work location state.


CARES ACT: PAYROLL TAX
DEFERRAL AND EMPLOYEE
RETENTION CREDITS

CARES Act: 6.2% Payroll Tax Deferral (§ 2302)

- Employers may delay payment of 100% of the employer share of Social Security tax (6.2%) on wages where such taxes are due between March 27, 2020 and January 1, 2021
  - Deadline for paying 50% of deferred taxes is December 31, 2021 (21 months)
  - Deadline for paying the remaining 50% of taxes is delayed until December 31, 2022 (33 months)
  - These delay relief provisions are available regardless of workforce size

CARES Act: 6.2% Payroll Tax Deferral (§ 2302) (cont.)

- Employers taking a CARES Act section 1102 SBA loan that is forgiven under CARES Act section 1106 or 1109 are not eligible for the 2302 payroll tax deferral holiday, for taxes owed in periods after the forgiveness, per FAQ 4 of the CARES Act guidance
  - Prior deferrals need not be repaid until the stated deadlines
  - If the SBA loan forgiveness does not happen until after 2020, the employer would receive all the benefit of the deferral

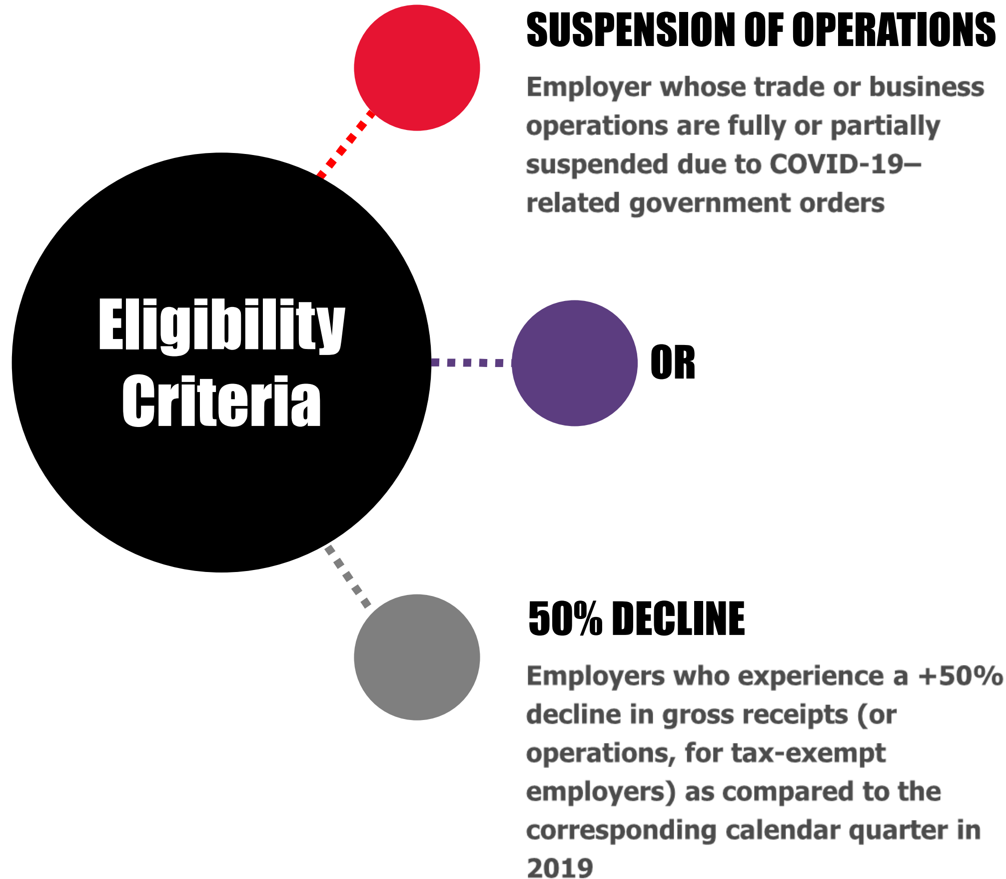
CARES Act: 6.2% Payroll Tax Deferral (§ 2302) (cont.)

- Not all employers have used this deferral (although, per rough estimates, @95% of employers are using the deferral)
- Complications for many employers were created because they did not start the deferral soon enough (i.e., the day the legislation was passed)
- Initially the IRS indicated informally that the deferral could be claimed against other taxes in Q2 2020
  - In draft Form 941 instructions issued in early May (after the Q1 return was filed), the IRS said that no credits or refunds would be allowed of the 6.25 amounts paid
  - The ABA has complained about this harsh conclusion, but no change in the draft instructions has yet been issued by the IRS

CARES Act Retention Credit (§ 2301)

Provides up to $5,000 in refundable tax credits for qualified wages paid to employees by an eligible employer who meets these eligibility criteria.

House-passed legislation would expand this credit to $12,000 per quarter.



CARES Act: Retention Credit (§ 2301) (cont.)

- The retention credit applies to 50% of “qualified wages” (capped at $10,000) paid between March 13, 2020 and Dec. 31, 2020
  - For employers with more than 100 full-time employees (determined using the Affordable Care Act's 30-hour/week measure), "qualified wages" available for tax credit include wages paid (including health benefits) to employees who are not providing services due to a shutdown or slowdown
  - For employers with 100 or fewer full-time employees, "qualified wages" available for a tax credit include wages paid (including health benefits) to employees, whether or not wages are paid due to a shutdown or slowdown
  - Aggregation rules apply to identify whether an employer has more than 100 employees

CARES Act: Retention Credit (§ 2301) (cont.)

- The retention credit is a fully refundable credit against the employer share of Social Security tax (6.2%), though it may be claimed through offset of other employment taxes (employer Medicare, employee Medicare, employee Social Security, employee federal income tax withholding) or advanced from the IRS via Form 7200
- Employers will report claims for credit on qualifying retention wages paid during Q1 (March 13–March 31) on the Q2 Form 941
- Employers taking a CARES Act section 1102 SBA loan are not eligible to claim the CARES retention credit
- Importantly — this rule prohibiting claims of the Employee Retention Credit (ERC) applies if any entity in the aggregated group obtained an SBA loan (However, this blocker would be changed by pending legislation to expand the ERC)
- For limited guidance on CARES retention credits, see: https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act.

Joint Committee Report on the CARES Act: Post-Enactment Legislative History

- On April 22, 2020, the Joint Committee on Taxation (JCT) issued a "Description of the Tax Provisions of P.L. 116-136, the Coronavirus Aid, Relief, and Economic Security "CARES") Act
  - There had been no committee reports accompanying the CARES Act, so this was a welcomed explanation of the rules
  - The provisions on the ERC (pages 37-42) are particularly useful, giving examples of qualifying employers and qualifying leaves
  - The report specifically authorizes the IRS to allow the ERC credit even when an employee was not receiving FICA-taxable cash wages, but instead was receiving only health benefits (which are also eligible for the credit)

Retention Credit FAQs: The Good, the Bad, and the Ugly

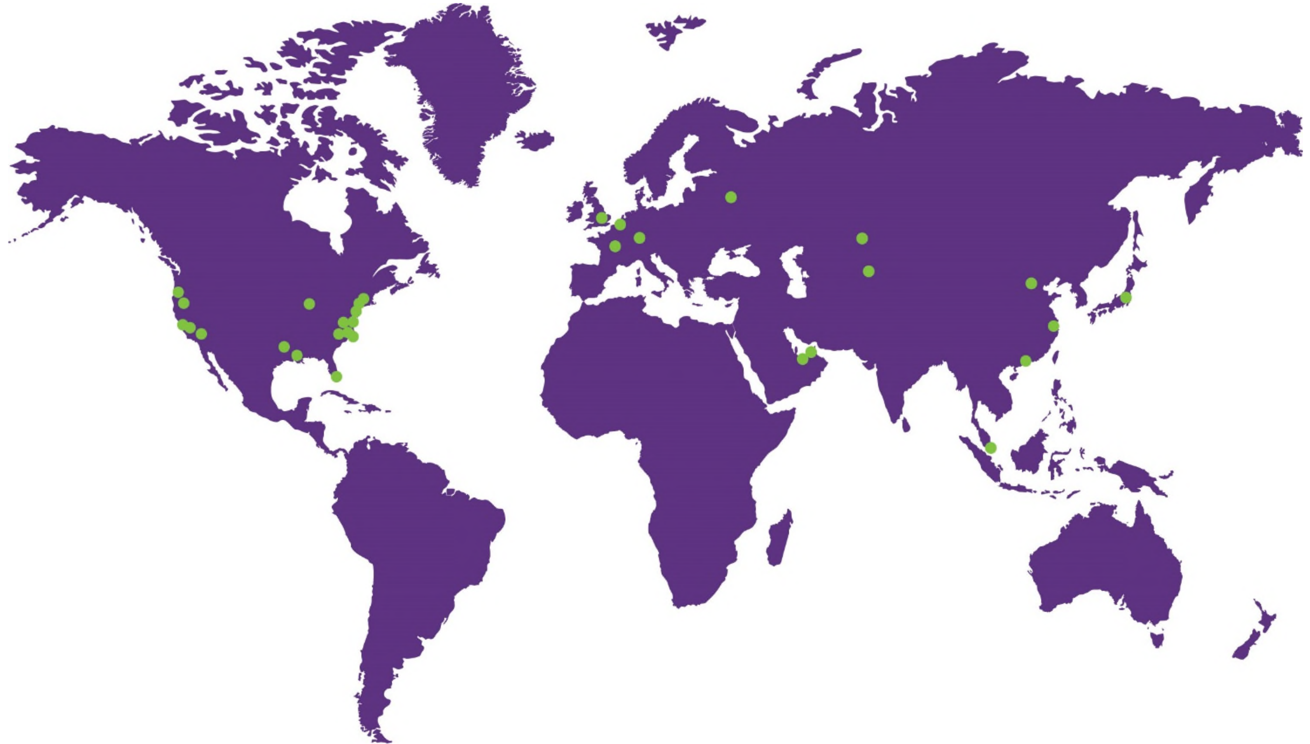
- On April 29, 2020, the IRS issued 94 FAQs on the CARES Act Retention Credit
  - **FAQ 64 and 65** denied any credit if an employer had furloughed workers without pay — which was an onerous result for the industries that had tried, at least, to continue health benefits
    - This terrible proposal was changed on May 7, 2020, with the release of new FAQs allowing the credit even if wages were not paid
  - **FAQ 33** denies the credit to any employer that is able to continue operations by having employees telecommute — which contradicts the example in the JCT report
  - **FAQs 56 and 57** deny any credit for employers of more than 100 employees for any leave payments (including sick and family leave) and for severance payments, even where the employer was not required by law or contract to make those payments. Non-leave payments to continuing employees unable to work still count, but without much guidance on the difference between furlough and severance

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



Morgan Lewis

*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

THANK YOU

© 2020 Morgan, Lewis & Bockius LLP
© 2020 Morgan Lewis Stamford LLC
© 2020 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.