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HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

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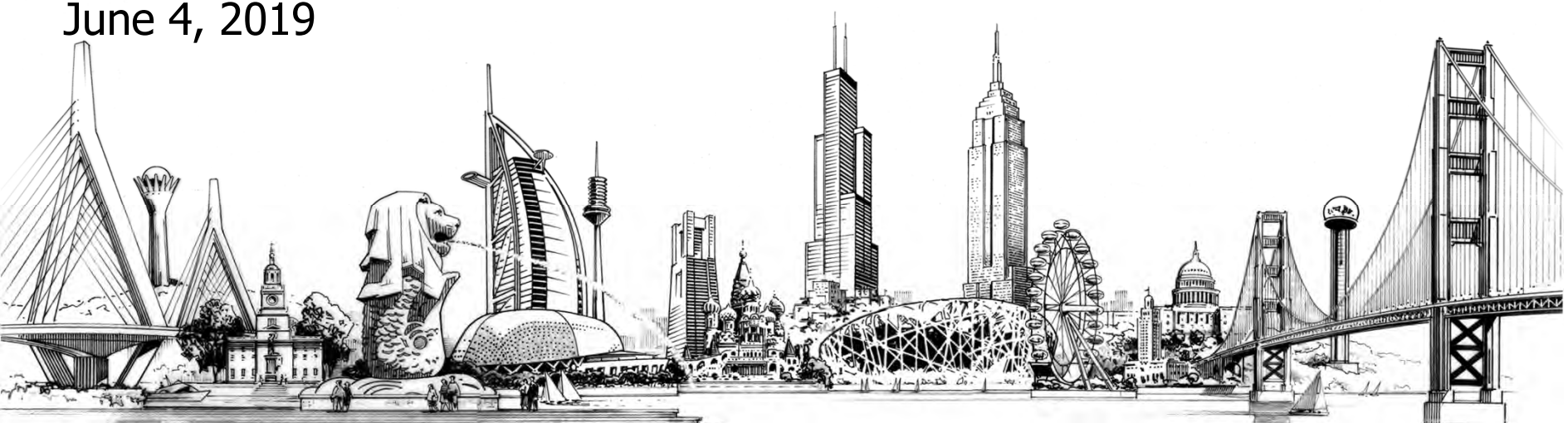

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Presenter: Claire Bouffard

PLAN SPONSOR CONSIDERATIONS IRS PROGRAM UPDATES

Changes to IRS Correction Program

- Expansion of "Self Correction Program" (SCP) of IRS' voluntary remedial correction program
  - Plan document failures (other than failure to adopt initial plan document)
    - Always treated as significant and must be corrected within the appropriate SCP time period (in general, within two years after occurrence of failure).
    - Favorable determination letter or opinion/advisory letter required.
  - Correction by amendment expanded
    - The SCP corrections by plan amendment previously available remain available.
      - 401(a)(17) failures, early inclusion of eligible employee, hardship distributions in plans that did not allow for them.
    - Expansion only available for amendments that meet certain conditions.
      - Must result in increase in "benefit, right or feature"
      - For all eligible employees
      - Must be a permissible amendment satisfying the correction principles.

Changes to IRS Correction Program

- Expansion of SCP (cont'd)
  - Loan Failures
    - Correction by plan amendment for number of loans in excess of plan terms
    - Defaulted Loans for failure to repay in accordance with plan terms
      - Lump sum payment, reamortization, or combination of the two.
      - No need to request that defaulted loan be reported in year of correction rather than year of failure.
    - 72(p) failures still must be corrected through VCP or Audit CAP
    - Failure to obtain spousal consent can be self-corrected, but if spousal consent is not obtained must be corrected through VCP or Audit CAP
  - IRS indicated it is formulating additional guidance regarding overpayments

Changes to IRS Determination Letter Program

- New Circumstances under which it's possible for an individually designed plan to apply for a favorable IRS determination letter (DL)
  - "Hybrid" DB Plans (e.g., a cash balance or pension equity plan)
    - Available for a limited time – September 1, 2019 - August 31, 2020
    - 2017 Required Amendments Lists (RALs) and all other RALs and Cumulative Lists prior to 2016
  - Mergers of formally unrelated plans
    - New circumstance is available indefinitely (beginning September 1, 2019), but time to apply for any particular plan merger is limited.
      - Plan must be merged by the last day of the first plan year following the plan year of the corporate transaction.
      - DL application must be filed by the last day of the first plan year following the year of merger
    - Review will be based on RAL issued during second full calendar year preceding submission (e.g., if filed on September 1, 2019, 2017 RAL)
- DLs continue to be available for new plans and on plan termination

Changes to IRS DL Program (cont'd)

- Provides schedule of sanctions related to merged plan failures discovered in DL review.
  - Plan document failures in merger amendment – no sanction.
  - Limited to VCP fee for merged plan document failures where:
    - Timely adopted amendment with "good faith" (as determined by the IRS) attempt at compliance; or
    - Reasonable and good faith determination was made that no change was needed.
  - All other merged plan document failures - 150% to 250% of VCP fee "depending on the duration of the error."
- Similar structure applies for hybrid plan submissions, except that the "no sanction" scenario is limited to final hybrid plan regulations and the sanction scenarios relate to all other plan document failures.

Presenter: Sage Fattahian

HEALTH AND WELFARE
IRS UPDATE: AFFORDABLE CARE ACT LETTERS, ROUND 2

Dual Enforcement Objectives

- Reporting the offer of coverage
  - Employer shared responsibility enforcement (§6056)
    - §4980H(a) penalty – offer MEC to substantially all ACA full-time employees
    - §4980H(b) penalty – minimum value (MV), affordability

- Transmittal Forms
  - **Form 1094-C**
    - Employer shared responsibility enforcement (§6056)
  - **Form 1094-B**
    - Individual shared responsibility enforcement (§6055)

Proposed Penalty Letters

- Content in 226J Letters
  - a brief explanation of section 4980H,
  - an employer shared responsibility payment summary table itemizing the proposed payment by month and indicating for each month if the liability is under section 4980H(a) or section 4980H(b) or neither,
  - an explanation of the employer shared responsibility payment summary table,
  - an employer shared responsibility response form, Form 14764, "ESRP Response",
  - an employee PTC list, Form 14765, "Employee Premium Tax Credit (PTC) List" which lists, by month, the ALE's assessable full-time employees (individuals who for at least one month in the year were full-time employees allowed a premium tax credit and for whom the ALE did not qualify for an affordability safe harbor or other relief (see instructions for Forms 1094-C and 1095-C, Line 16), and the indicator codes, if any, the ALE reported on lines 14 and 16 of each assessable full-time employee's Form 1095-C,

Proposed Penalty Letters

- Content in 226J Letter cont..
  - a description of the actions the ALE should take if it agrees or disagrees with the proposed employer shared responsibility payment in Letter 226J, and
  - a description of the actions the IRS will take if the ALE does not respond timely to Letter 226J.
- 30-day response time
- 30-day extension (automatically granted)
- If you fail to respond, IRS issues a follow-up letter with a 15-day response time
  - If you fail to respond penalty assessed

Proposed Penalty Letters

- What we have seen:
  - 226J letters for the 2015 calendar year were issued in 2018
    - Generally (a) and (b) penalty letters
  - 226J letters for the 2016 calendar year were issued this year (2019)
    - Generally (a) and (b) penalty letters
- IRS using reported data to issue letters based upon codes
- Most proposed penalties can be avoided to due reporting errors based on good faith exception
- Proposed failure to file penalty notice (employer forms)
  - Suggests that IRS is using this data in a more thoughtful manner

Presenter: Julie Stapel

FIDUCIARY

BACK TO THE FUTURE—THE SEC AND STATES GRAPPLE WITH RULES ON FIDUCIARY CONDUCT

Developments on Fiduciary Conduct Rules

- Last summer, a Fifth Circuit Court of Appeals ruling overturned the DOL's fiduciary "conflict of interest" rules.
  - To recap: The DOL's fiduciary rules would have re-defined "fiduciary" investment advice under ERISA and significantly expanded those that would have been treated as an ERISA fiduciary (subject to ERISA's stringent fiduciary conflict of interest rules).
- But no one really expected the Fifth Circuit's ruling would be the last word on the subject.
- Most recently, the SEC and different states have continued to consider the issue and have proposed different sets of rulemaking – which differ from the DOL's vacated conflict of interest rules.

Developments on Fiduciary Conduct Rules

- SEC Initiatives
  - Proposed "Regulation Best Interest" that would establish a "best interests" standard of conduct for broker-dealers and their associated persons applicable to "retail customers."
  - "Retail customers" is proposed to include participants in ERISA-covered plans and IRAs.
  - Many in the industry have favored the SEC's principles-based approach in its proposal.
  - Some state regulators have criticized the proposed Regulation Best Interest as too lenient and relying heavily on disclosures to address conflicts.
  - Others have questioned whether fiduciaries of "small plans" should be considered "retail customers" and whether different rulemaking should apply to advice provided in the context of plan rollover decisions.
  - A final rule is expected later this year – maybe even this summer.

Developments on Fiduciary Conduct Rules

- State Initiatives
  - Six states currently have proposed or adopted rules addressing fiduciary standards, with more expected to follow.

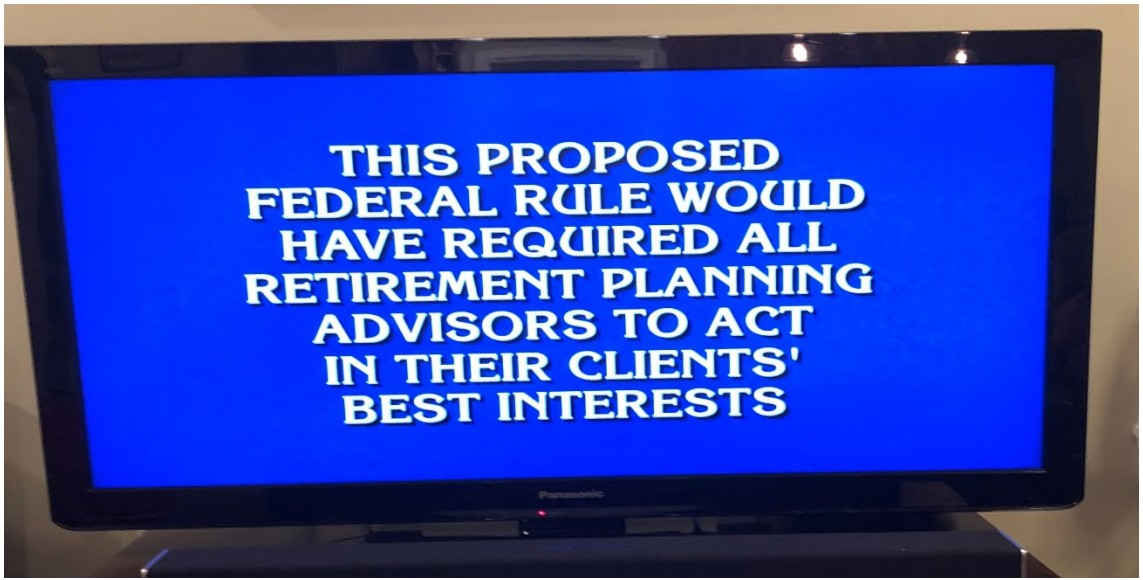
State	Summary of Initiative
Connecticut	Requires disclosure of investment option fees and returns and fees paid to advice providers.
Maryland	Financial Consumer Protection Act voted down by Maryland Senate Finance Committee—would have imposed a best interest standard.
Massachusetts	Proposed disclosure obligations on state-registered investment advisers. Requires a one page fee disclosure in a standalone document (not part of Form ADV Part 2A).
Nevada	Proposed regulation that would impose a best interest standard and other requirements.
New Jersey	Proposed legislation to require non-fiduciaries to disclose that status. Proposed regulations to establish a "uniform fiduciary standard." Open for comments until June 14.
New York	Regulations effective in 2019 and 2020 imposing "best interest" standard on life insurance and annuity transactions. Proposed legislation to require non-fiduciaries to disclose that status.

But Don’t Count the Department of Labor Out Yet

- At a House Education and Labor Committee hearing, Secretary of Labor Alexander Acosta said the DOL “will be issuing new rules in this area” based on the DOL’s ongoing collaboration with the SEC in the development of the SEC rules.
- This got the attention of the financial services industry as it was not clear whether the DOL intended to re-engage on fiduciary conduct standards or not.
  - One speaker even went so far as to characterize the DOL’s fiduciary rule as a “zombie rule” that could not be allowed to come back to life.
- On May 23, the Office of Management and Budget published the DOL’s regulatory agenda, which projects a December 2019 release date for a proposed rulemaking on the fiduciary rule.
- Of course, it remains to be seen how much it will have in common with its prior version.
  - The SEC’s version (expected this summer) may be a sneak preview.

And, Finally, What Is the Fiduciary Rule, Alex?

- Our little corner of the world made the big time on the Jeopardy! Teachers Tournament last month with this clue:



- And not only did I get it right from my sofa, the contestant got it right too!

Presenter: Erin Randolph-Williams

EXECUTIVE COMPENSATION

PRACTICAL ISSUES ARISING IN CONNECTION WITH SHARE WITHHOLDING FOR TAXES

FASB Standard on Stock Withholding to Satisfy Tax Obligations

- The prior rule:
  - To maintain favorable equity classification treatment for a share-based award, cash settlement of the award for tax withholding purposes could not exceed the minimum statutory withholding requirement
- The current rule:
  - Permits tax withholding on share-based awards up to the maximum statutory rate
  - Effective for annual reporting periods beginning after December 15, 2016 (public companies) or December 15, 2017 (private companies) and interim periods within those annual periods
  - Many equity compensation plans have the minimum statutory tax rate "hardwired" into the plan, so that an amendment is required to effect this change

Stock Exchange Listing Rules

- NYSE rules require shareholder approval of any "material revision" to an equity plan. However, under recent NYSE guidance, a plan amendment to provide for the withholding of shares based on the participant's maximum tax obligation (or compensation committee discretion to authorize such withholding) is not a material amendment if the shares withheld were never issued
- NASDAQ FAQs have been updated to follow suit - generally, an amendment to increase the withholding rate to satisfy tax obligations would not be considered a material amendment to an equity compensation plan requiring shareholder approval

Federal Tax Withholding on Equity Awards

- Federal income withholding obligations arise when share awards *vest,* are *settled,* or (nonqualified options and SARs) *are exercised*
- Federal tax withholding on equity awards can be determined in one of two ways:
  - By treating the payment as a supplemental wage payment subject to the 22% withholding rate on supplemental wages up to $1 million (37% on supplemental wages of greater than $1 million); or
  - By applying the withholding amount generated by an employee's Form W-4

Share Withholding for Taxes

- In order to exempt the disposition of shares through share withholding from being a "sale" of shares under Section 16 (insider trading rules), Rule 16b-3(e) requires advance approval by the Compensation Committee or the Board
- The Compensation Committee should approve the resolutions before any shares are withheld for Section 16 officers
- The company should not retain discretion to determine whether shares will be withheld, or the amount of share withholding, for Section 16 officers
- Rule 16b-3(e) requires that the advance approval be specific, but there is no guidance from the SEC as to how much specificity is needed

Share Withholding for Taxes (cont.)

- An SEC CDI indicates that share withholding for Section 16 officers should not exceed the participant's estimated federal state, local, and foreign tax obligations attributable to the underlying transaction

Mechanics of Changed Share Withholding for Taxes

- An employee may file a revised Form W-4 claiming a reduced number of exemptions or entering a specific dollar amount of increased withholding as a means of increasing the withholding rate toward the 37% level
- The IRS process does not allow an employee to specify a percentage rate for federal income tax withholding on Form W-4
- The Form W-4 must apply to all wages paid to the employee while the Form W-4 remains in effect
- Procedures should be implemented to ensure that an employee who increases tax withholding through Form W-4 does not direct withholding of amounts in excess of the maximum applicable tax rate or, in the case of Section 16 officers, the estimated taxes on the equity award distribution
- So, the employee should not request an additional amount of withholding on Line 6 of Form W-4 that would result in a withholding percentage that is greater than the employee's highest marginal federal plus state tax rate, or liability accounting will apply

Mechanics of Changed Share Withholding for Taxes (Cont.)

- From a tax perspective, a company does not have to treat all employees the same with respect to tax withholding on shares. Employers can therefore accommodate the preferences of their award recipients
- Companies should discuss the increased withholding with their payroll departments and stock plan administrators to understand any additional administrative limitations on implementation

Share Withholding for Taxes and Exercise Price Payment –Section 16 Disgorgement Claims

- New Section 16 disgorgement claims being made that seek to match open market purchases by Section 16 insiders with exempt-reported tax and exercise price withholding transactions elected by Section 16 insiders
- Letters were sent to dozens of companies and the claimants have filed multiple lawsuits following company refusals to disgorge profits from insiders

Presenter: Anna Pomykala

FRINGE BENEFITS

BEST PRACTICES IN EMPLOYER-PROVIDED SNACKS AND MEALS

Employer Provided Meals and Snacks: Brief Background

1. Internal Revenue Code section 119 excludes from gross income the value of any meals provided for "the convenience of the employer."
2. Free meals and snacks are a common fringe benefit, particularly among technology and financial services companies.
3. Companies have many reasons for providing meals and snacks on-site, including:
   - time savings as compared to eating off-site
   - supporting employees who may respond to emergencies or experience peak workloads during mealtime

TAM 201903017: Overview

- The IRS National Office recently published guidance on whether meals and snacks are excludable under sections 119 and 132(e) in the form of Technical Advice Memorandum 201903017 (the "TAM")
- The TAM provides some taxpayer-favorable guidance on the section 119 "convenience of employer" exclusion, but it is also heavily IRS-favorable

  (+) Snacks and beverages served in breakrooms generally qualify for exclusion as de minimis fringe benefits under section 132(e)(1)

  (+) Meals from home should not be considered in determining whether employer-provided meals fall within the "inability to secure a proper meal within a reasonable meal period" safe harbor of Reg. § 1.119-1(a)(2)(ii)(c).

  (-) Rejecting many of the taxpayer's business goals as being too "general" to rise to the level of a "substantial" business reason

Best Practice Recommendations: Cafeteria and Breakroom Design

- Organize cafeterias to maximize efficiencies, e.g., provide easy access to pre-packaged grab-n-go meals
- Provide snacks in breakrooms that are healthy, inexpensive, and not considered a meal substitute
- Provide bulk offerings instead of single-serving-size packs
- Set up cafeterias in a way that encourages collaboration, e.g. provide long group tables
- Locate breakrooms in between unrelated employee groups to encourage employee interactions across teams and departments.

Best Practice Recommendations: Recordkeeping

- Identify employees who:
  - need to be available during meal periods to respond to urgent incidents
  - experience peak workloads during meal periods
- Identify office locations with insufficient dining alternatives nearby or factors that make it difficult for employees to get a meal off site in less than 1 hour
- Track meals provided to visitors, contractors, and employees visiting from other offices
- Ensure that any policy changes that could impact hourly/non-exempt employees are developed together with labor and employment advisors.

Best Practice Recommendations: Communications to Employees

- Discourage employees from taking food home
- Communicate the non-compensatory reasons why the Company provides meals to employees.
- Promote any nutrition or other wellness programs explicitly as a complement to the Food Program.

Biography

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Julie K. Stapel helps employee benefit plan sponsors and financial service providers with the investment, and management of employee benefit plan assets. She advises clients on ERISA fiduciary and prohibited transaction rules, and their impact on investment products and services, and helps those clients use investment documentation and other tools to manage potential fiduciary risks while providing top-quality benefits and services. She also works with plan sponsors and financial service providers to address ERISA–related compliance issues.

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Saghi (Sage) Fattahian counsels clients on all aspects of health and welfare plans. She works with clients to comply with the complicated, shifting requirements under the US Internal Revenue Code, ERISA, ACA, COBRA, HIPAA, MHPAEA, GINA, and state and local laws. She assists health and welfare plans and their sponsors with daily operations and plan administration, including preparing and maintaining plan documents and related materials; reviewing and negotiating services agreements with third parties; consulting on operational issues; and assisting with claims and appeals.

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Erin Randolph-Williams is part of a team that helps clients find solutions to their employee benefits–related problems. She counsels clients on employee benefits matters, including design, implementation, and administration of cash or deferred compensation arrangements, nonqualified deferred compensation plans, and executive and equity compensation arrangements. Erin negotiates employment agreements and severance arrangements for senior executives, and advises clients on all employee benefits and compensation-related aspects of mergers, acquisitions, sales and spin-offs.

Biography

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Claire E. Bouffard counsels clients on employee benefits and executive compensation. She drafts and assists with design of tax-qualified pension and profit-sharing plans, cash or deferred arrangements, health and welfare arrangements, deferred compensation plans, and employment agreements. In addition, Claire reviews and edits plan documents and amendments to ensure compliance with applicable law; drafts communications materials and notices to plan participants; and files voluntary correction program submissions. Claire assists with benefit plans in every stage of their lives—from inception or acquisition to termination or divestiture.

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Anna M. Pomykala works with a team of employee benefits lawyers to assist clients in finding creative solutions to their employee benefit–related business challenges. Our clients include small, middle-market, and Fortune 500 companies in the technology, consumer goods, retail, pharmaceutical, healthcare, hospitality, and energy industries. We also represent many financial institutions, startups and tax-exempt organizations, educational institutions, and state and local governments. Prior to joining Morgan Lewis, Anna earned her LL.M. in taxation from New York University School of Law.

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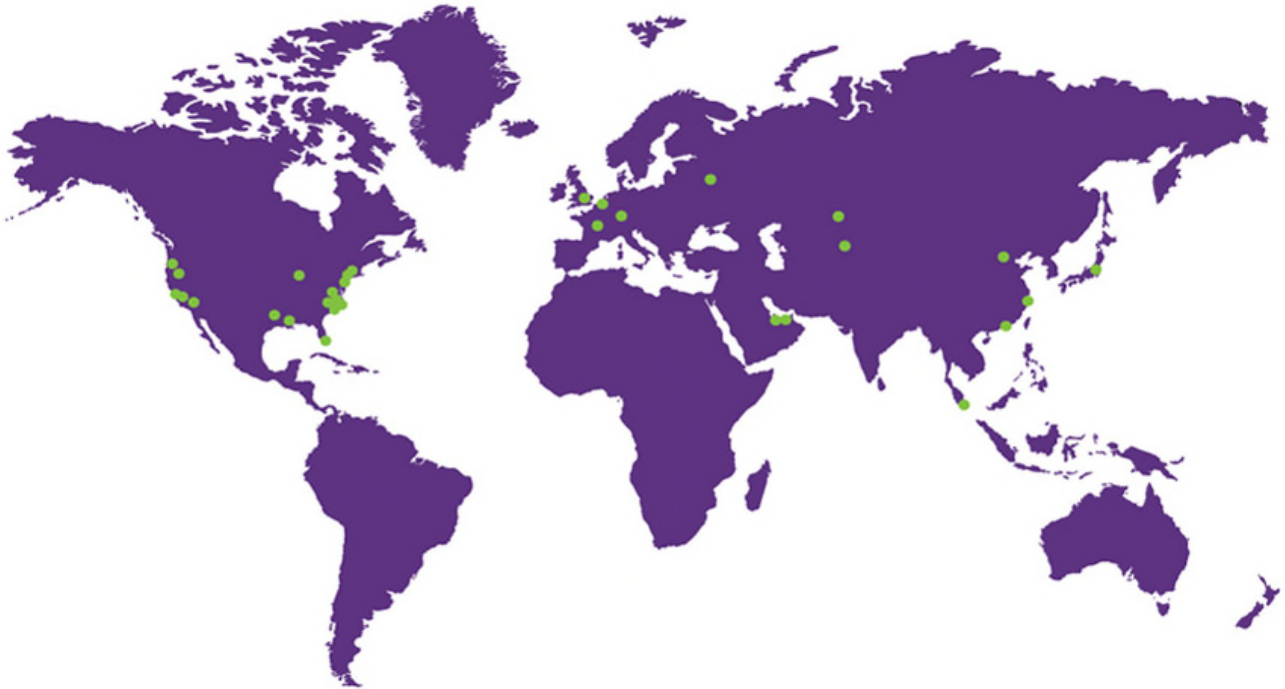

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