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HOT TOPICS IN EMPLOYEE BENEFITS: WHAT WE'RE SEEING

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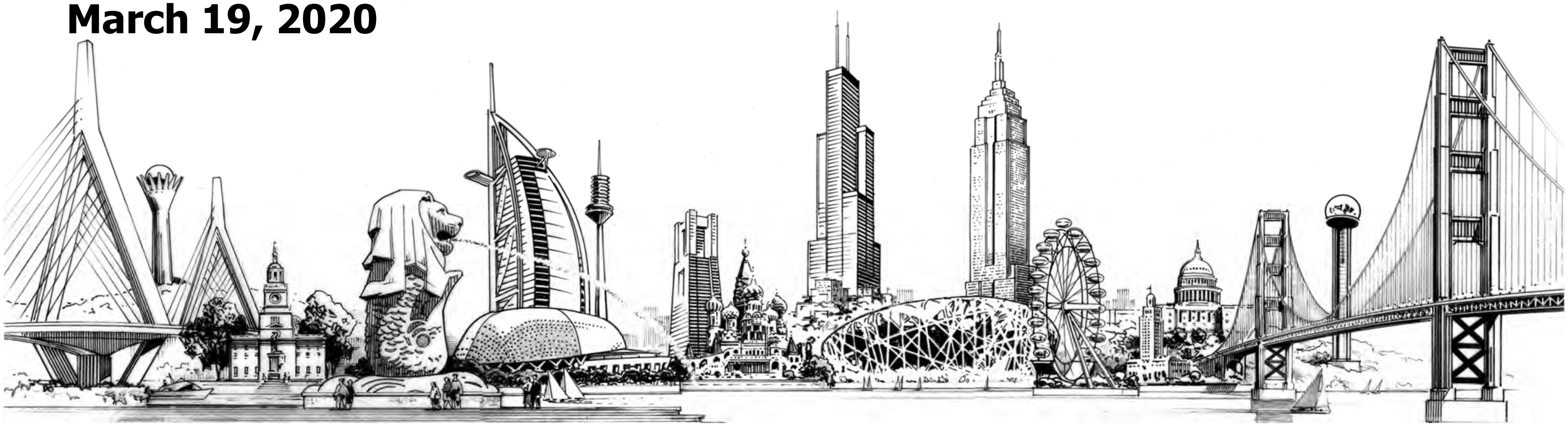

Agenda

- **HIPAA and COVID-19**
  Michelle McCarthy and Sharon Masling
- **Fiduciary Issues Presented by the SECURE Act**
  Liz Goldberg
- **Plan Sponsor Perspectives on the SECURE Act**
  Bill Marx
- **Income Tax Withholding in Light of New IRC 3401 Regulations**
  Handy Hevener and Steve Johnson
- **Executive Compensation Considerations for Proxy Season**
  Lauren Sullivan

HEALTH & WELFARE

HIPAA & OTHER BENEFITS ISSUES ARISING FROM COVID-19

HIPAA & COVID-19

- **Protects individuals' medical records and other personal health information (PHI)**
- **State privacy laws**
  - HIPAA preemption
  - State law applies if it is more stringent
- **Only applies to covered entities and their business associates**
- **Excludes employment records**
  - Records needed for the employer to carry out its obligations under the FMLA, ADA, and similar laws; and
  - Files or records related to occupational injury, disability insurance eligibility, sick-leave requests, drug screenings, workplace medical surveillance, and fitness-for-duty tests of employees
- **HIPAA authorizations**
  - Providers may disclose exam/test results to employer pursuant to authorization
    - Employee may revoke authorization; however
    - Provider may refuse to perform exam/test (under HIPAA) without authorization
  - Employer may condition employment on provision of HIPAA authorization

HIPAA/COVID-19 HHS Guidance

- **Office of Civil Rights (OCR) February 3, 2020 Bulletin**
  - HIPAA Privacy Rule still applies during COVID-19 outbreak
  - HIPAA specifically includes exceptions for these types of occurrences
- **March 15, 2020 HHS Bulletin**
  - Waivers for hospitals within 72 hours of disaster protocol implementation
  - Reiterates privacy/disclosure rules in emergency situation
- **Permitted Disclosures**
  - **Treatment and Operations**
  - **Public Health Activities**
    - Public health authorities (CDC and local health authorities)
    - Direction of public health authorities to foreign government agency
    - Persons at risk where state law does not preclude disclosure
  - **Notification to Family, Friends, Others Involved in Individual's Care**
  - **To Prevent or Lessen Serious and Imminent Threat**
  - **Minimum Necessary**

Safeguarding Information

- **Reasonable Safeguards Under HIPAA**
  - Applies even in disaster situations
  - Includes administrative, physical, and technical safeguards for electronic PHI
  - *Avoid employee snooping*
- **Safeguards Where HIPAA Doesn't Apply**
  - Health information provided to employer
  - Confidential medical information under ADA
  - Must be kept in separate file from personnel records
  - Not as extensive as HIPAA

FAQs re: HIPAA and COVID-19

- **An employee calls in sick to work and informs her manager that she has COVID-19. Is this information protected under HIPAA?**
  – No. The information was voluntarily disclosed by the employee in relation to the employee's employment. Note, however, that information about an employee's medical diagnosis might be considered information about a person's disability and thus should be treated as a confidential medical record.
- **Employer self-administers its group health plan. A COVID-19–positive employee tells the HR director, responsible for overseeing the group health plan administration, that he has tested positive for COVID-19. Is this information protected under HIPAA?**
  – If the HR director has any doubts as to the context in which the information was shared (i.e., the employee was informing the HR director of his illness because the employee had human resource questions about sick leave/disability versus questions about group health plan coverage or continuation), before disclosing the information to a supervisor, the HR director may want to first consult with the group health plan's HIPAA Privacy Officer and/or employee benefits counsel. Again, under the ADA, this might be considered information about a person's disability.

FAQs re: HIPAA and COVID-19 (cont.)

- **Because of the COVID-19 outbreak, an employer hires a medical professional to conduct employee temperature screenings before employees are allowed to report to work. Would this violate HIPAA?**
  - Most likely not. Even where this arrangement was deemed to be an on-site medical clinic or facility, it would fall under the HIPAA exclusion for on-site clinics and facilities, so long as no standard transactions are conducted electronically. Because we are in a pandemic, the ADA's general prohibition on medical exams does not apply.
- **An employer runs an on-site medical clinic. The employer notices that an employee looks ill and requires that the employee immediately report to the clinic for COVID-19 testing. The employee tests positive. Is this information protected under HIPAA?**
  - If the on-site clinic does not conduct standard transactions electronically then the COVID-19 test results would not be protected information under HIPAA. Even where the clinic does conduct electronic standard transactions, this information may fall under the public health activities exception to HIPAA and could be disclosed to persons at risk so long as this would not create issues under any other applicable law. Under the ADA, however, this information is likely considered disability-related medical information and should be treated as a confidential medical record.

FAQs re: HIPAA and COVID-19 (cont.)

- **Same example as above, may the employer share the COVID-19 test results with co-workers with whom the COVID-19–positive employee worked closely within the last week?**
  - No, the information in the employer's possession is not subject to HIPAA. An employer is not a covered entity subject to HIPAA. (Note, that the employer's group health plan is not permitted to share information with the employer under HIPAA.) If the employee (or a public health agency) notifies the employer that he/she tested positive for COVID-19, the information is not subject to HIPAA.
    - Under the ADA, however, the information should be treated as confidential medical information and kept separate from the employee's personnel file.
    - The employee's identity should not be revealed to others.
    - Employees who were in close contact with the individual should be advised that they were in close contact with an individual who has tested positive for COVID-19, that they should self-quarantine for 14 days, that they should monitor themselves for symptoms, and that they should contact their healthcare provider if they develop any symptoms.

NOTE: ***These slides consider whether HIPAA applies to information regarding COVID-19. Please note, however, that other laws, like the ADA and state privacy laws, also control. Under the ADA, information about a person's COVID-19 status would likely be considered disability-related information and, therefore, should be treated as a confidential medical record.***

Other Health & Welfare Issues Arising from COVID-19

- **Families First Coronavirus Response Act, Division F Section 6001**
  - Private health plans must provide coverage for COVID-19 testing
    - Cost of provider/urgent care center/emergency room visit
    - No cost sharing
- **High-Deductible Health Plans**
  - Provision of COVID-19 testing and treatment
  - Option and not requirement for HDHPs
- **Continuation of coverage for employees no longer working**
  - Loss of "full-time" status
  - Inability to pay premiums
- **Telemedicine Services**
- **Stop-loss coverage for self-insured group health plans**

SECURE ACT
FIDUCIARY CONSIDERATIONS

Lifetime Income Option Safe Harbor

The SECURE Act adds a new Lifetime Income Option Safe Harbor

- Historically there has been a desire by plans and fiduciaries to help participants in defined contribution plans convert their account balance into a long-term source of retirement income (i.e., a “lifetime income option”).
- However, there has been hesitancy to do so because plan fiduciaries have been concerned about potential liability they may face for the selection of such lifetime income options, such as in the selection of an annuity provider.
- The SECURE Act provides a new safe harbor that defined contribution plan fiduciaries can rely on in selecting lifetime income investment providers.

Safe Harbor Requirements

The Safe Harbor is in a new Section 404(e) of ERISA. It provides that a fiduciary will be deemed to satisfy its obligations in selecting an insurer for a lifetime income option contract if the fiduciary:

- Engages in an "objective, thorough, and analytical search" for the provider;
- Considers "the financial capability of such insurer to satisfy its obligations under the guaranteed retirement income contract"; or
- Weighs "the cost (including fees and commissions)" of the lifetime income option in relation to the "benefits and product features of the contract and administrative services to be provided under such contract."

Safe Harbor Benefits

On requirement two—considering the financial capabilities of the insurer, the SECURE Act provides that a fiduciary will be deemed to satisfy that evaluation if "at the time of selection" the insurer is provides a specific representation on financial capability.

- This is a key protection under the safe harbor because it allows the fiduciary to rely on a representation by the provider.
- Also, it applies at the time of purchase or the time of the selection, not at the future date of benefits.

- Plan fiduciaries that satisfy these requirements and qualify for the safe harbor are shielded from liability with respect to participant losses in the event of the annuity provider's inability to pay the full benefits when they are due.

- The SECURE Act offers no effective date, but it is generally assumed that the safe harbor is effective immediately.

- It is expected that there will now be more defined contribution plans that build lifetime income components into their plan, relying on the safe harbor.

Lifetime Income Option Portability

Portability of lifetime income investment options

- Currently, if a plan offers a lifetime income option as an available investment and decides to eliminate it, the participant would have to take a distribution or be mapped to a different investment option.
- However, if the participant is actively employed, distributions may not be available, meaning that fiduciaries considering elimination of the lifetime income option would need to consider redemption fees and other charges when mapping to a different investment.
- The SECURE Act allows participants the opportunity to keep these investments by allowing a plan to permit in-service and in-kind distributions of lifetime income investments if the investment is no longer authorized to be held under the plan.
- New portability right allows rollovers while in service.
- Effective for distributions made after December 31, 2019.

Disclosure and Reporting Changes

- Lifetime Income Disclosure
  - Defined contribution plans, whether or not any lifetime income investment options are available under the plan, must include a lifetime income disclosure at least once in every 12-month period on benefit statements.
  - The lifetime income disclosure must show the monthly payments that the participant would receive if his or her entire account balance were used to provide lifetime income in the form of a joint and survivor or single-life annuity.
  - This change applies to benefit statements furnished more than 12 months after the DOL issues final rules, model disclosures, and assumptions.
  - The SECURE Act directs the DOL to issue interim final rules, model disclosures, and assumptions that plans may use in developing their disclosures; this change applies to benefit statements furnished more than 12 months after the DOL issues such guidance.
- Consolidated Form 5500 Reporting
  - The SECURE Act directs the IRS and the DOL to modify annual retirement plan reporting rules to permit plans with the same trustee, fiduciary, and investment menu to file a consolidated Form 5500.
  - The consolidated form will apply to returns and reports for plan years beginning after December 31, 2021.

Pooled Employer Plans

The SECURE Act allows for Pooled Employer Plans (PEPs)

- The SECURE Act loosens under ERISA and the Internal Revenue Code of 1986, as amended (the Code) to facilitate the creation of "open" multiple employer plans (MEPs) (called PEPs under the SECURE Act).
- This is an improvement from the traditional MEPs. MEPs are centrally administered retirement plans in which multiple "employers" participate. The DOL has read into ERISA's definition of "employer" a requirement that adopting employers of a MEP share an "employment based common nexus" and exercise control over the MEP.
- Advocates for open MEPs argue that MEPs provide a great vehicle to help small business owners and their employees save for retirement, and that MEPs provide significant economies of scale and scope.

Pooled Employer Plans (cont.)

Under the SECURE Act, PEPs are:

- Centrally administered defined contribution plans that can be joined by multiple unrelated employers.
- The PEP will be established, maintained, and administered by a pooled plan provider (PPP)
  - The PPP will likely be a retirement services firm (such as an insurance company, bank, trust company, consulting firm, recordkeeper, or TPA).
- The SECURE Act amends ERISA's definition of "employer," eliminating the "nexus"/"commonality" requirement (e.g., a common industry or geographic proximity).
  - Amends ERISA to define a PEP to be a plan:
    - That is an individual account plan established or maintained for the purpose of providing benefits to the employees of two or more employers;
    - That is tax qualified under Code section 401(a) or a plan that consists of accounts described in Code section 408; and
    - Whose plan document includes certain specified terms.
  - These definitions do not permit defined benefit PEPs, and do not appear to envision 403(b) PEPs.

Pooled Employer Plans (cont.)

What if a participating employer fails to meet tax-qualification requirements?

- The SECURE Act amends the Code to address what is known as the "one bad apple" rule—the situation where one participating employer fails to meet the requirements for tax qualification, and the tax qualification of the entire MEP is jeopardized.
  - Many believed this to be a primary deterrent for MEP participation.
- Under the new law, if certain requirements are met, a PEP will not be treated as failing to meet the PEP requirements solely because a participating employer fails to meet its obligations to the PEP, and the SECURE Act establishes a process to address the failure.
- In the event of a failure, assets attributable to that employer are transferred out of the PEP to another retirement plan or account unless Treasury and/or the DOL determines that it is in the "best interests" of the employees to retain the assets in the PEP.
- The offending employer, and not the PEP or other participating employers, will be responsible for any associated liabilities resulting from the failure.

Pooled Employer Plans (cont.)

- We anticipate that retirement services firms of different types (insurance companies, banks, trust companies, consulting firms, recordkeepers, TPAs) will consider becoming PPPs of PEPs.
- What else to keep in mind?
  - The SECURE Act directs the DOL and IRS to issue additional guidance around PEPS.
  - The SECURE Act provisions impacting PEPs become effective December 31, 2020.

PLAN SPONSOR PERSPECTIVES ON THE SECURE ACT

Participant Required Beginning Date

- Participant Required Beginning Date (RBD) increased to age 72
  - Previously, the RBD for a participant was April 1 following the later of the year in which the participant attains age 70½ or terminates employment
  - The SECURE Act increases the age trigger for the RBD from age 70½ to age 72
    - **EXAMPLE 1**: Participant A reached age 70½ on December 30, 2019. Participant A must begin distributions on April 1, 2020 (absent an exception)
    - **EXAMPLE 2**: Participant B will reach age 70½ on January 1, 2020. Participant B will reach age 72 in 2021. Participant B must begin distributions on April 1, 2022 (absent an exception)
  - Plans can require distributions to be made prior to the RBD and as early as age 65 (e.g., at normal retirement age), if desired
  - Applies to defined contribution plans (e.g. 401(k), 403(b), 457), defined benefit plans, and IRAs

- *Effective for any participant who reaches age 70½ after December 31, 2019*

Beneficiary Distribution Deadlines

- Distribution deadlines accelerated for designated beneficiaries who are not "eligible designated beneficiaries" (eliminates/limits certain "stretch" distributions)
  - Previously, a plan could allow any designated beneficiary (e.g., natural person) to "stretch" certain distributions from a plan over the beneficiary's remaining life expectancy
  - The SECURE Act limits the time permitted to take a full distribution of inherited plan or IRA assets to 10 years (for designated beneficiaries)
  - This new limit does not apply to certain "eligible designated beneficiaries," including a surviving spouse, a minor child (until age of majority), a disabled person, a chronically ill person, or any person not more than 10 years younger than the participant
  - The SECURE Act does not change the five-year limit for nondesignated beneficiaries (e.g., estates)
  - Applies to defined contribution plans and IRAs

- *Effective with respect to participants who die after December 31, 2019*

Long-Service Part-Time Employee Eligibility

- Requires elective deferral eligibility for long-service, part-time employees
  - Previously plans could exclude employees unless/until they completed 1,000 hours of service in a plan year
  - The SECURE Act requires plans to allow any part-time employee who has worked at least 500 hours in each of the immediately preceding three consecutive 12-month periods the opportunity to make elective deferrals
  - Plans are not required to provide other employer contributions to employees who were excluded under the 1,000 hours of service threshold but become eligible under the new rule
  - Special rules are provided to ensure that extending participation to these part-time employees does not adversely affect nondiscrimination testing
  - Applies to 401(k) plans

- *Effective January 1, 2021; service prior to January 1, 2021 need not be taken into account, so participant eligibility will not begin until 2024*

Child Birth or Adoption Distributions

- Child Birth or Adoption Distributions
  - o Provides special rule where plans can permit penalty-free distributions of up to $5,000 for expenses related to the birth or adoption of a child
  - o Distribution is not subject to a 10% early distribution penalty or mandatory 20% withholding
  - o Distribution must be taken within 12 months of eligible birth or adoption
  - o Can later be repaid to a qualified retirement plan as a rollover
  - o No guidance yet on how this is accomplished or whether there are any time limits

- *Optional provision can be added for distributions after December 31, 2019*

Plan Amendment Deadlines

- Legally required amendments must be adopted by the end of the second calendar year following the year they are included on the IRS Required List (e.g., the earliest would be the 2020 Required Amendments List for items effective in 2020)
- For discretionary amendments, the SECURE Act includes an extended deadline for their adoption, which will be the last day of the first plan year beginning on or after January 1, 2022 (e.g., December 31, 2022 for calendar-year plans)
- Collectively bargained plans have until the last day of the first plan year beginning on or after January 1, 2024 (e.g., December 31, 2024 for calendar year plans)
- Disaster relief amendments (not part of the SECURE Act, but passed along with the SECURE Act) must be adopted by the last day of the first plan year beginning on or after January 1, 2020

INCOME TAX WITHHOLDINGS IN LIGHT OF NEW IRC 3401 REGULATIONS

Overview: Purpose and Operation of Form W-4

- The Federal Income Tax Withholding (FITW) system was designed in the late 1940s to ensure that employees had amounts withheld from their wages ratably over the calendar year, that were estimated to be adequate to cover the employee's income tax liability for the whole year.
- Since 1987, employees have been required by the regulations to estimate the income taxes that they expect to owe for the current year, and NOT to base their withholding estimate on the "prior year" rule that applies for purposes of estimated income taxes.
- Thus, any employees with income fluctuations between calendar years are definitely NOT allowed simply to use the "prior year rule" of Code section 6654(d) (which applies for estimated tax purposes), and calculate their total withholdings for a high-income year based on the applicable percentage of the prior year's taxes — i.e., paying only 100% (increased to 110% for taxpayers with AGI of more than $150,000) of the taxes owed for the prior year.
- The instructions for the Form W-4 were also specifically designed to prevent employees from attempting to minimize their withholding throughout the year, and then increasing withholding at year-end, thereby attempting to take advantage of Code section 6654(g), which, for purposes of determining whether a taxpayer is subject to penalties for the underpayment of estimated taxes, deems any taxes withheld on wages as being paid over the course of the taxable year in four equal installments. Under this rule, wage withholdings at year-end are thus deemed to be retroactively prorated, and can make up for any underpayments of estimated taxes on deposit dates earlier in the year.

Overview: Purpose and Operation of Form W-4 (cont.)

- However, despite the Form W-4 instructions, this relation-back rule also has effectively encouraged employees to try to INCREASE withholding at year-end.
- The problem created by frequent changes in Forms W-4, with high withholding at year-end and low withholding earlier in the year, is that the IRS could allege that the employee is NOT complying with the regulatory instructions on completing Form W-4.
- These W-4 changes (and the amounts of exemptions and allowances claimed) have increased after 2005, when (effective April 14, 2005) the IRS issued regulations eliminating the long-standing requirement that employers send the IRS copies of Forms W-4 claiming more than 10 exemptions ("Questionable Forms W-4"). The IRS reserved the right to request the W-4 forms, per written notices, but seldom does that.
- Note: Most states DO still require the filing with the state of state-level Forms W-4 with more than 10 withholding exemptions (or "exempt status" changes), but not the IRS.

Overview: Purpose and Operation of Form W-4 (cont.)

- Only one Form W-4 can be on file at any point in time. *See* Treas. Reg. § 31.3402(f)-1(a)-(c) discussing the filing, and correction, and refiling of "a signed withholding exemption certificate," which must be changed if the employee believes that his or her tax liability for the year has changed, compared to the assumptions applied with the prior Form W-4 that was signed and filed.
- Thus an employee is not allowed to keep two Forms W-4, using one for equity compensation and the other for regular compensation. This "single W-4" rule was adopted by the IRS to block employees from switching back and forth too frequently with changes in withholding requests.
- Too-frequent changes in Forms W-4, switches back and forth between different exemption amounts, creates a presumption that one or more of the employee's Forms W-4 filed during the year has not been an honest indication of expected annual income, just because it is illogical that an employee's estimates of total taxes owed for the year would be subject to such frequent fluctuations.
- Employees who are trying to avoid overwithholding on income (but who also want to have 37% withholding on equity) also cannot file an "exempt status" Form W-4, requesting complete exemption from withholding for periods after that Form W-4 is filed, because an "exempt status" W-4 requires the employee to attest that the employee had no tax in the prior year and expects to have no income tax in the current year. (The new proposed regulations clarify this point, noting that use of the 22% supplemental rate is inapplicable if the employee has an "exempt status" Form W-4 on file.)

Overview: Prohibition on Election of Specified Withholding Rates

- The Form W-4 does not allow an employee to state the percentage rate of withholding that the employee wants to have withheld. Instead, the W-4 requires each employee to enter the number of exemptions that the employee wants to claim, and allows the employee to request an additional dollar amount of withholding, but not a specific rate of withholding.
- The IRS is well aware that its regulations refer specifically (and only) to specifying a "dollar amount" of withholding. In Information Letter 12-0063 (8/17/2012), the IRS warned taxpayers that "if … an employer elects to use the optional flat rate withholding, rather than the aggregate [Form W-4] procedure, the prescribed option flat rate must be applied, no deviation from that rate is permitted, and employee requests for additional withholding have no effect." (A similar response had been provided in 1997, in response to another request for an IRS "information letter.")

Overview: Prohibition on Election of Specified Withholding Rates (cont.)

- Any writing on the Form W-4 (including a request for a percentage rate of withholding) will be treated as invalidating the Form W-4, and requires the employer to treat the employee as a single employee with no withholding exemptions (or, alternatively, to revert to the last valid Form W-4 on file). (*See* Reg. § 31.3402(f)-1(e), providing that any "alteration or unauthorized addition" to the Form W-4 will cause it to be considered a "nullity"; Prop. Reg. § 31.3402(f)-1(f)(3).)
- But instead of switching back and forth between different Forms W-4, <u>any employee</u> can keep the same Form W-4 on file throughout the year (or change the W-4 only a minimal number of times), and also instruct the payroll department to <u>always</u> (or sometimes) "apply Form W-4 withholding" to equity compensation (or certain types of equity compensation, or also to bonuses), and any such request can always be respected, so long as the employee's "supplemental wages" are under $1 million (since a flat rate 37% locks in at $1 million).
- This request to "apply Form W-4 withholding" almost always means that for equity events in the middle of any period, that "income spike" causes the effectively annualized income in that pay period to reach the 37% withholding bracket on that specified income.

Overview: Prohibition on Election of Specified Withholding Rates (cont.)

- Notably, the payroll tax regulations do allow payroll departments to accommodate individual requests from employees that the Form W-4 rate be used, instead of the 22% flat rate, without the need for a Form W-4 to be filed.
- *See* Treas. Reg. § 31.3402(g)-1(b), indicating that an employer can decide, for any employee, to apply either flat rate or W-4 rate withholding to supplemental wages under $1 million. The Preamble to these regulations (T.D. 9276) similarly stated that "the final regulations continue to provide that if the supplemental wage payment is paid under the conditions permitting the use of optional flat rate withholding, the decision whether to use optional flat rate withholding rather than the aggregate procedure is discretionary with the employer." There is no indication in either the regulation or the preamble that this "discretionary" decision by the employer necessarily has to be applied to all employees.
- Thus, by switching back and forth between the 22% flat rate for some supplemental wages (e.g., a cash bonus) and the W-4 rate for other supplemental wages (e.g., equity compensation), an employee may be able to avoid excessive annual withholding, while still ensuring withholding at a rate close to 37% on equity compensation. If the employee thinks that enough has been withheld during the year, the employee can change the equity compensation withholding request back to 22% (unless the employee has $1 million in supplemental wages).

Overview: Prohibition on Election of Specified Withholding Rates (cont.)

- Notably, it would have been a lot simpler for the IRS, in designing the new post-TCJA withholding regulations (released February 11, 2020) simply to allow employees to keep an election on file to allow specified flat rates of withholding at designated percentages.
- But, the IRS seems incontrovertibly opposed to such elections of specified rates.
- Notably, in soliciting public comments on the design of "alternative withholding methods" in the new proposed regulations, the proposed regulations' Preamble notes that "the Treasury Department and the IRS again request comments on alternative withholding procedures under section 3402(h) generally. However, the Treasury Department and the IRS do not consider allowing employees to base their withholding on a fixed dollar amount or percentage as consistent with section 3402(a)." (85 Fed. Reg. 8360.)
- So, on THIS issue, the IRS consistently opposes the idea of "alternative" withholding instructions, as well as the simplicity of "employee selection of a flat rate." But, as discussed below, in implementing the TCJA changes, the IRS has been willing to have "two Form W-4 structures" — one preserving the "old law" Forms W-4, while trying to translate those instructions into post-TCJA tax tables, and one under the TCJA.
- Further, since payroll departments are not authorized to challenge employees' claims of "withholding allowances," it appears that many of the Forms W-4 on file end up with effective withholding rates of "zero" or "10%" despite the fact that the TCJA changes have disparate effects on taxpayers, and do not uniformly reduce income taxes.

TCJA Changes

1. Rate Reductions (top rate reduced from 39.6% to 37%; supplemental rate reduced from 25% to 22%)
2. Added two new rates (now 10%, 12%, 22%, 24%, 32%, 35%, and 37%) (but included higher rates for married and filing separately).
3. Nearly doubled the standard deduction, and added allowances based on the increased child tax credit and new non–child dependent tax credit.
4. Eliminated Personal Exemptions and many itemized deductions, including:
   – State/local tax deductions over $10K
   – Employee business expense deductions
   – Interest on mortgages over $750K
   – Clawback deductions
   – Moving expense deductions
   – Alimony for divorce decrees after 2018

So few deductions remain that millions more people, effective in 2018, claimed the standard deduction in filing their federal income tax returns.

Very Slow Changes in Regulations and Withholding Forms and Table

- Withholding Changes Were Scheduled to Come in Phases, per a "Transition Period" Allowed by the TCJA for 2018 that was EXTENDED through 2019.
  - First Phase: Jan. 11, Updated Notice 1036 (new withholding tables)
  - Second Phase: Jan. 29, Notice 2018-14, Publication 15
  - Third Phase: The New Form W-4; Individual Withholding Calculator – released Feb. 28, 2018 (and needing corrections and a name change)
  - Fourth Phase: Repeated revisions in (and reproposals of) Form W-4 and in the IRS's "Tax Withholding Estimator"

- The Final "new W-4" not released until Dec. 11, 2019 (two years after enactment of the TCJA) and even that form was revised on January 15, 2020 to reflect a change in the medical expense deduction limit.

- The "Withholding Estimator" has also been updated several times, although it's not clear how many employees use it.

Substantial Underwithholding for 2018

- The first year of the TCJA rate changes resulted in substantial underwithholding for employees across the US, who had never adjusted their Forms W-4 to prevent underwithholding resulting from taxpayers' claims of dozens of Form W-4 exemptions that no longer "worked" for Form 1040 purposes (after the TCJA's elimination of personal exemptions and many itemized deductions).
- The IRS issued two waivers of income tax underpayment penalties — ultimately waiving penalties if taxes were only 15% underpaid. Notice 2019-25 expanded the waiver to persons whose total withholding and estimated tax payments equaled at least 80% (reduced from 85 percent in Notice 2019-11) of the tax shown on the return for the 2018 tax year.
- Reversing the IRS's acceptance, for decades, of employee practices to at least slightly overpay withholdings, and get tax refunds, Commissioner Koskinen said in a speech to Congress about the 2019 filing season: "There is a reasonable debate about whether it is better for taxpayers to have less tax withheld throughout the year and receive smaller refunds (or owe a balance) as opposed to having more tax withheld throughout the year and receiving larger refunds. Many economists argue against big refunds, saying that taxpayers are better off getting to keep more of what they earn throughout the year and not 'giving the government an interest-free loan.' Others argue that a large segment of taxpayers consciously uses the government as a savings vehicle and prefers to receive a large check once a year. In my opinion, there is no single 'correct' answer. Taxpayers will have different preferences." (3/7/2019, 2019 TNT 46-42.)
- Given this ambivalence, there was no widespread IRS program warning taxpayers to avoid underwithholding — although it is not clear that the IRS will waive penalties in 2020 for 2019 underwithholding.

IRPAC Recommendations in October 2018

In October, 2018, the IRS's "Information Reporting Program Advisory Committee" issued a report:

- Criticizing the IRS's decision to continue the use of both pre-2020 and post-2019 Forms W-4, as a decision that creates confusion among taxpayers, undue complexity for payroll departments, and substantial underwithholding.
- Noting that "despite the IRS's efforts to inform taxpayers to check their withholding and encourage the use of the 'calculator' on the IRS website, usage of the 'calculator' through completion has been minimal."
- Recommending that ALL employees be required to file the new Form W-4 by October 1, 2020.
- Do NOT adopt an assumption that employees who have not filed a Form W-4 or have an invalid Form W-4 before 2020 should be treated as "single with zero allowances," because that results in overwithholding for such employees.

IRPAC Recommendations (cont.)

- Ensure that ALL employees use the IRS's "tax calculator" on the IRS website.
  1. Update the withholding calculator to account for the 2020 Form W-4 and W-4P (and the TCJA changes that are very different from the withholding system used since the 1950s), and avoid if possible the complexities of having to provide the prior year tax return as well as current paystubs to use the calculator.
  2. Consider having a "short form" calculator. This could be provided by using questions that would determine if the taxpayer could confidently skip the more detailed questions that do not apply.
  3. Enhance the calculator to produce a Form W-4 that is ready for submission to the employer upon completion of the calculator.
  4. Require employers to distribute the 2020 Instructions for Form W-4 to all employees or provide the link to the document's location on the IRS website to the employees (to eliminate historic concerns of employers that they should NOT assist employees with Form W-4 completion, to avoid being put in the role of a tax advisor).

IRS Response in Proposed Regulations (Issued Feb 11, 2020): Mandatory Use of New Forms Limited to New Employees, or Rejected W-4s, or Certain "Status Changes"

- The IRS rejected IRPAC's recommendation to require all employees to submit "new" Forms W-4 during 2020.
- Instead, only employees "first paid" after 2019 have to complete the new Form W-4, and employees whose Form W-4 has been rejected as invalid. Prompt changes are also required for employees who have divorced, or who have changes in numbers of dependents, or who have certain other "changes in status" listed in Prop. Reg. § 31.3402(f)(2)-1(b)(2) which would change income or taxes by more than stated "*de minimis*" amounts (e.g., wage increase of $10K, tax credit change of $500). (However, leeway is allowed for changing to the "new" Form W-4 until December 10 of the "status change" year (to be effective for the next calendar year), and if the employee "expects to have withholding that is greater than the amount of the employee's income tax liability.") (It is not clear how that expectation is to be proved.) Note, too, that employees whose spouses die can continue to elect "married filing jointly" for two years and use the old Forms W-4 if they are each a "surviving spouse" or "qualifying widow[er]."
- Thus, given the numerous waivers of any need to file a new W-4 (except where divorces and deaths result in reversion to "single" status), coupled with the lack of any cross-check for accuracy of employees' claimed status and allowances, payroll departments likely will continue to have to use two sets of withholding tables indefinitely.
- Notably, there are some implicit incentives provided to switch to the new Form W-4 (discussed below). However, many employees will likely simply continue to be underwithheld, until the point that underpayment penalties are no longer waived. (No penalty waiver has been announced for 2019 returns.)

Underwithholding Will Continue for Many Employees

- Any employees who have claimed personal exemptions based on provisions eliminated by the TCJA will continue to have their personal exemption respected (thus reducing their income by $4,300 for each claimed exemption), but may have substantial underwithholding.
- Example: Married employee earning $250K (could be split between spouses), with the following deductions: $35K, income and real estate taxes, $25K moving expenses (or casualty losses), $20K in employee business expenses, $5K in interest, and $5K to a 401(k) plan.
- This employee correctly figured $90K in deductions (under "old law"), and historically has claimed 21 personal exemptions on his Form W-4 (checking "married filing jointly"). The tax withholding is calculated by continuing to apply a $4,300 allowance for each of the 21 claimed allowances, and applying an $11,900 effective standard deduction (equaling the TCJA standard deduction for a married person of $24,800, adjusted to subtract three $4,300 allowances). Per the tables for the "old forms," FITW withholding would be $24,096.
- But the income tax owed per the new tax calculator (and the inflation-indexing in Rev. Proc. 2019-44) would be $41,007! This employee is thus **nearly $17K underwithheld**.
- If the IRS does not continue to waive underwithholding penalties, this employee would have an incentive to file the "new" 2020 version of Form W-4.

Employees with Non-Filed or "Invalid" Forms W-4 are Worse off when Using the Old (pre-2020) Forms

- Employees who are not required to file the new Forms W-4, but who have not filed a form at all, or who have filed a Form W-4 that is deemed to be invalid, are treated as "a single person claiming no withholding exemptions" (unless there is a prior Form W-4 that was filed that was valid). (*See* Reg. § 31.3402(f)(2)-1(a) and -1(e).)
- By contrast, any employee who is required to file a "new" Form W-4 (i.e., hired after 2019), who fails to file the form, or who files "new" Form W-4 that is deemed to be invalid, is treated as "single but having the withholding allowance provided in forms, instructions, publications, and other guidance prescribed by the Commissioner." Prop. Reg. § 31.3402(f)(1)-1(a)(4) and 31.3402(f)(2)-1(f)(3). Currently those instructions provide for the claim of the higher standard deduction. The Preamble of the proposed FITW regulations recognizes that a person subject to the 2020 Form W-4 rules would thus have less withholding than an employee subject to the pre-2020 Form W-4 rules, so this curious rule also may operate as an incentive for an employee to file a 2020 Form W-4 — whether valid or invalid — to qualify for a withholding reduction.

“Exempt Status” Claims from 2019 Expire 2/18/2020

- Any employee who has claimed “exempt status” in 2019 had that claim expire 2/18/2020 (because those claims must be renewed annually), so a new Form W-4 must be submitted.
- If no new form is submitted, the payroll department must treat the employee as “single” — with no entry filed in Step 2, 3, or 4 of the “new” Form W-4 (which basically allows the standard deduction and applies the TCJA tax tables). Importantly, unlike the old regs, the proposed regulations do NOT require the employer to put in place the prior Form W-4 that predated the expired “exempt status” form.
- But, a new Form W-4 can be filed, although the proposed regulations clarify the standards for claiming exempt status (no income tax last year, and no tax expected for the current year), by adding rules to Prop. Reg. §31.3402(n)-1(c) about the effect of certain tax credits, and of married employees who file separate returns. (85 Fed. Reg. 8630-8631.)
- Notably, payroll departments are <u>not</u> required to check the accuracy of “exempt status” claims. However, an employee filing a false Form W-4 can either be fined $500 (the civil penalty under Code section 6682), or the IRS could attempt to impose criminal penalties under Code section 7205(a) (involving a fine of $1,000, or a year in jail). These penalties are not mentioned in the Form W-4 instructions.
- Payroll departments must, however, ensure that an employee who has claimed “exempt status” file a separate **state-level** Form W-4, because these proposed regulations clarify that any “exempt status” claim does NOT apply to state income tax withholding (reflecting a 1990 statutory change that had not previously been picked up in the regulations).

Expectation of Being "Married Filing Separately"

- The proposed regulations change the prior rules on election of "married" status on Form W-4, warning that not only does the employee have to be legally married when the Form W-4 is filed (which has always been a requirement for electing this status on Form W-4), but also the employee also must not expect to file a Form 1040 to elect "married filing separately," because the tax tables under the TCJA for "married filing separately" yield substantially higher taxes than the tables for "married."
- Divorced persons may not file a Form W-4 electing "married" status.
- Any person who is a nonresident alien, or is married to a nonresident alien during the calendar year, also may not elect "married filing jointly" status unless the employee also expects to elect to file separate returns under the procedures of Section 6013(g).

Persons Married Filing Separately Earning over $311K

- The proposed FITW regulations do NOT provide special tables for any persons who are married filing separately, and instead mandate use of the "single" employee tables by any employee who expects to file separately from a spouse.
- This produces automatic underwithholding for a person who is married filing separately, because the Code section 1(j) tables start the 35% tax rate at $311,025 for a person who is married filing separately, while the rate continues at 32% for a single person (and in the withholding tables) for income between $311,025 and $518,400. Thus, the underwithheld taxes for each person who is married filing separately could equal as much as **$4,147** (for each such married person, if each person earns over $311,025). (That's as much as $8,294 of underwithholding, just because there is no special withholding table for marrieds filing separately.)

Special Rules for Nonresident Aliens

- Although Code section 3402(f)(6) provides that a nonresident alien individual (other than an individual treated as a resident who is described in section 3401(a)(6)) shall be entitled to one withholding exemption, the IRS has concluded that this reference to a "withholding exemption" is the deduction under Code section 151, which for 2018-2025 means "Zero." The proposed regulations include this clarification. (Notably, residents of Canada, Mexico, and South Korea, who historically — under Notice 2005-76 — were allowed to claim more than one personal exemption, may also have their taxes increased.)
- For 2020, nonresident aliens are instructed to "review and apply Notice 1392 to determine how to complete the 2020 Form W-4." Employers are instructed to apply special procedures in Publication 15–T for these individuals (which in turn explain that the treatment depends upon whether the nonresident alien has filed a "new" 2020 Form W-2).
- Nonresident aliens (other than students or business apprentices from India) are also not entitled to have the standard deduction applied to their wages. (This rule predated the TCJA, and the exception for Indian students/ apprentices is based on the US-India Treaty, per Notice 2005-76.) Thus adjustments must be made to add back the standard deduction that is a component of the withholding calculations (with different adjustments applying, depending on whether the nonresident alien has or has not filed the 2020 Form W-2).
- But, because the historic "add-back" prior to 2018 equaled only $2,300 (one withholding allowance), this new required "add-back" (based on the standard deduction) — which is $8,100 for NRAs with old W-4s, and $12,400 for NRAs with new W-4s — will substantially inflate the wages of nonresident aliens for withholding purposes.

In Claiming "Allowances" for Expected Tax Credits on the New Form W-4, Employees can Claim Credit for FITW Already Withheld

- The pre-TCJA rules did not allow employees to take withholdings under Code section 31(a) into account in calculating the exemptions to be claimed on Form W-2. (Reg. § 31.3402(m)-1(b)(2)(ii).)
- The new proposed regulations (as was promised in Notice 2018-92) do allow employees to take FITW into account, in calculating allowances to be claimed, provided that the withholdings have actually been collected from the employee's wages.
- The Tax Withholding Estimator on IRS.gov explains how these computations work.
- Thus, for example, if an employee has elected "Form W-4 withholding" for equity compensation, the Form W-4 filed early in the year could not take into account the FITW on that compensation, but as the year progresses, the employee would be able to claim increasing numbers of allowances, as the withholding built up.

In Claiming "Allowances" for Expected Tax Credits under New Form W-4, No Offset is Required for Gross Income Exempted from Withholding

- The proposed FITW regulations include a new instruction for employees calculating "allowances" in completing the 2020 Form W-4, providing that employees are no longer required to offset any claims for expected tax credits claimable on Form 1040 (such as the child care credit or the dependent care credit) simply because they have income from which no Federal income tax has been withheld. (Any allowance claims based on available deductions are required to be offset by income amounts from which no taxes were withheld.)
- Comments have been requested on this rule that clearly is designed to allow employees to claim allowance credits under Code section 3402(m), thereby reducing withholding, even when the employees may have substantial income that is exempt from withholding (e.g., cars, ISOs/ESPPs, group term life insurance, or contractor income).

Payroll Department Confirmation of W-4 Accuracy Still Not Required (Same as Prior Law)

- Treas. Reg. § 31.3402(f)(2)-1(e) provides that withholding certificates should be rejected where "the employee clearly indicates [the W-4] to be false by an oral statement or a written statement made by him to the employer on or before the date on which the employee furnishes such certificate." But, if no such statement is made, technically the employer is authorized to accept the certificate (unless the SSN is "obviously incorrect" — e.g., uses all-repeater numbers, or letters instead of numbers, or has blanks instead of some numbers).
- Also, Treas. Reg. §31.3401(e)-1(b) provides that "the employer is not required to ascertain whether or not the number of withholding exemptions claimed [on a Form W-4] is greater than the number of withholding exemptions to which the employee is entitled." (Unclear if confirmation of marital status is required.)
- The only changes made in these rules by the FITW proposed regs is to move the first rule to Prop. Reg. § 31.3402(f)(2)-1(f)(3), and to remove Reg. § 31.3401(e)-1 (because it refers to obsolete "withholding exemptions"), but to move the substance of the rule waiving any need for an employer to confirm the accuracy of withholding allowances to Prop. Reg. § 31.3402(f)(1)-1(b).
- The proposed regulations do not require any printout or other confirmation that the employee used the Withholding Estimator on the IRS's website to confirm the taxes likely to be owed.
- Here, again, the filing of a false Form W-4 can attract either a $500 civil penalty under Code section 6682, or possible criminal penalties under Code section 7205(a) (involving a fine of $1,000, or a year in jail). However, again these penalties are not mentioned in the Form W-4 instructions.

No Response Required to IRS on Receipt of a "Lock-in Letter" for a Former Employee

- The IRS tries to identify employees whose withholding is artificially low during the year, and then sends "lock-in letters" to the employer to require increases in withholding.
- Notably, after 2005, the IRS no longer requests the filing of Forms W-4 with more than 10 exemptions, so it has no ready access to employees who may have artificially decreased withholding during the year.
- But, if "lock-in letters" are sent (i.e., indicating that the IRS has located an employee with artificially low withholding), until 2018, the IRS used to require the employer to notify the IRS if the employee was no longer employed (so, presumably, the IRS could track that employee at a different employer).
- The proposed regulations adopt the rule announced in Notice 2018-92, which had removed the requirement that the employer notify the IRS if an employee covered by a "lock-in letter" is no longer employed by that employer. (The proposed regs' Preamble, at 85 Fed. Reg. 8346, noted that one commentator thanked the IRS for this rule.)

Changes in Timing of When Forms W-4 Take Effect

- The proposed regulations also update the timing of when a new Form W-4 must take effect (reflecting a 1987 statutory change that had not been added to the regulations).
- Specifically, if a Form W-4 had not been previously filed, it should take effect for wages paid in the next payroll period. (However, if the employee is paid wages without regard to any payroll period, the new W-4 must be made effective for the first wage payment after it is furnished.)
- However, any other change in a Form W-4 can have a delayed effective date, and need not be applied by the employer until the beginning of the first payroll period ending (or the first payment of wages made without regard to a payroll period) on or after the 30th day after the day on which the new Form W-4 is furnished.
- An employer may elect to put a Form W-4 into effect earlier than these deadlines, but no sooner than the day after the Form W-4 is furnished.
- Finally, it is permissible for employers to collect or employees to provide Forms W-4 that are intended to take effect in the next calendar year, and those instructions must be respected.

Guidance on IRS.Gov

- Prior to 2020, the IRS was issuing guidance about post-TCJA withholding in Notice 1036. However, the proposed regulations indicate that this Notice 1036, as well as general guidance for "automated" filers of Form W-4, will simply be posted on the IRS.gov website, because it is available faster that way to taxpayers, and enables the IRS to "quickly update" its guidance.
- The one problem with such "guidance on the web" is that changes effectively replace the guidance that was there before, so it is difficult to track the changes (or even to know exactly what has changed, unless taxpayers continually print out current versions of postings on the IRS website).
- Also, as a technical matter, the list of "substantial authorities" under Code section 6662 that can be relied upon for purposes of abatement of any tax understatement penalties do not list ephemeral guidance posted on IRS.gov as a "substantial authority."

NAEA Survey

- A survey conducted by the National Association of Enrolled Agents (NAEA) reveals that taxpayers are likely ill-informed about the TCJA changes that may personally impact them.
- The survey reveals that even though many taxpayers were surprised to receive smaller refunds for the 2019 tax year, it is likely that many have not adjusted their withholdings for the current tax year.
- The NAEA identified the following challenges for the 2019 tax year that tax professionals should look to mitigate for the 2020 filing season:
  - Taxpayers unaware of changes in withholding
  - Taxpayers misinformed about tax law changes
  - Taxpayers confused about choosing between itemizing or taking the standard deduction
  - Returns taking much longer to prepare
  - Taxpayers unprepared for the impact of the SALT deduction limitation

Revived Form 1099-NEC for 2020 Payments

- The IRS released its final version of Form 1099-NEC to be used for reporting nonemployee compensation (current and deferred compensation to independent contractors and corporate directors).
- Form 1099-NEC (previously retired in 1982) replaces Box 7 of the pre-2020 Form 1099-MISC for reporting nonemployee compensation and accelerates the due date for reporting nonemployee compensation to the IRS to January 31 from the end of February (for paper filings) or March 31 (for electronic filing).
- With this change and the IRS and payees receive the compensation information statements on January 31, and the IRS has until at least February 15 to confirm the information before issuing any refund to taxpayers claiming the Earned Income Tax Credit or the Additional Child Tax Credit.
- Nonemployee compensation generally includes $600 or more in fees, commissions, prizes, and awards for services performed as a nonemployee, and other forms of compensation for services performed for a trade or business by an individual who is not an employee.

Other Changes to Form 1099-MISC

Box Number(s)	Pre-2020 Form 1099-MISC	2020 Form 1099-MISC
1-6	Rents, royalties, "other income," federal income tax withheld (if any), fishing boat proceeds, and medical/health payments	Same
7	Nonemployee compensation	Amounts previously reported here were moved to Form 1099-NEC, and this 1099-MISC Box is used for payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale
8	Substitute payments in lieu of dividends or interest	Same
9	Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale	Crop insurance proceeds
10	Crop insurance proceeds	Gross proceeds paid to an attorney
11	Blank Box	Same
12	Blank Box	Section 409A deferrals (optional box)

Other Changes to Form 1099-MISC (cont.)

Box Number(s)	Pre-2020 Form 1099-MISC	2020 Form 1099-MISC
13	Excess golden parachute payments to a nonemployee	Same
14	Gross proceeds paid to an attorney	Nonqualified deferred compensation for a nonemployee that violates Section 409A (also reported in Box 1 of 1099-NEC)*
Box 15a for pre-2020 Form; Box 15 for 2020 Form	Section 409A deferrals (optional box)	State tax withheld
15b	Nonqualified deferred compensation for a nonemployee that violates Section 409A	Boxes 15a and 15b consolidated into Box 15 (and used for state tax withheld)
16	State tax withheld	State/Payer's state no.
17	State/Payer's state no.	State income
18	State income	Box 18 eliminated

EXECUTIVE COMPENSATION CONSIDERATIONS FOR PROXY SEASON

Overview of Hot Topics

- Say on Pay and Equity Plan Approval
- Glass Lewis and ISS Compensation Updates for 2020
- ISS Shareholder Rights and Governance Updates for 2020

Say on Pay

- Say on Pay (SOP) vote
  - o The vast majority of companies “passed” SOP
    - – 99% of S&P 500 companies received majority support for SOP
    - – 97% of Russell 3000 companies received majority support for SOP
  - o Reasons for failure include:
    - – Performance standards that are not sufficiently rigorous
    - – Problematic pay practices
    - – Lack of responsiveness to shareholder concerns
  - – Despite continued overall passage rates, ICR Inc. recently noted that 2019 saw a “marked rise in the percentage of SOP with support rates below 80%”
    - o 80% is significant, as this is the level at which shareholders and proxy advisors will scrutinize compensation committee members for their oversight of the compensation program and responsiveness to investor concern
    - o ICR attributes this to:
      - – Passive investors’ lack of willingness to support one-time retention or discretionary awards
      - – Investors increasingly willing to vote against SOP to register concerns over problematic pay practices

Equity Plans

- The vast majority of companies that put up equity plans for shareholder approval saw success in 2019
  - Average level of support approximated 90% among both Russell 3000 and S&P 500 companies
  - Few companies in the Russell 3000 had equity plan proposals that failed to achieve majority support
- Strategies when faced with a negative ISS recommendation:
  - Shareholder engagement, focusing on largest institutional holders
  - Well-drafted supplemental proxy material can be effective to rebut ISS’s position (particularly if Glass Lewis has expressed support for the plan)

2019 Proxy Disclosure and ISS Issues

- Performance metrics
  - ISS uses a quantitative review in its evaluation of pay for performance based upon three primary measures and one secondary measure.
  - In 2020, ISS will continue to use the three primary measures but is reviewing the secondary measure through an Economic Value Added (EVA) framework. The framework applies certain rules-based adjustments to financial statement accounting data in an effort to offer a "uniform" non-GAAP basis for evaluating performance across companies.
  - In 2020, ISS will incorporate EVA metrics in the secondary financial performance assessment component of the quantitative Pay-for-Performance model.
  - The GAAP metrics used by ISS in past years will continue to be displayed in ISS research reports for informational purposes only.
  - It is not expected that ISS's use of EVA will result in more companies using EVA for performance metrics in incentive plans.

ISS 2020 Compensation Policy Updates

- Starting in 2020, ISS will begin recommending against board members responsible for nonemployee director pay if there is a pattern of excessive pay over two or more years without a compelling rationale
  - o Pay outliers will generally be those directors whose pay exceeds the top 2% of all comparable directors (based on index and industry median)
  - o If director pay is determined to be an outlier, ISS will perform a qualitative test to analyze factors that may mitigate concerns and disclosure
  - o Benchmarking and fulsome director compensation disclosure is important
  - o The following circumstances, if adequately explained, will typically mitigate ISS concern:
    - – One-time onboarding grants for new dirctors
    - – Payments related to corporate transactions or special circumstances (such as special committee service)
    - – Payments in consideration of specialized scientific expertise

ISS 2020 Compensation Policy Updates (cont.)

- ISS has clarified its expectation of fulsome disclosure of payments made to terminating executives, stating that severance pay is not appropriate for executives who voluntarily resign or retire
  - Clear and direct disclosure about the nature of an executive’s termination
  - Disclosure as to how the board of directors determined to pay severance to the executive, including whether there were any discretionary enhancements
  - Identify the type of termination (termination of employment without cause/resignation for good reason) and the applicable agreement provision under which severance payments were made

Glass Lewis 2020 Compensation Policy Updates

- Responsiveness to Low Support for Say on Pay
  - Low support equates to an opposition of 20% or more
  - Expects "robust disclosure of engagement activities and specific changes made in response to shareholder feedback"
  - Absent such disclosure, "may consider recommending against the upcoming say-on-pay proposal"
  - Appropriate responses to such low shareholder support include:
    - Engaging with large shareholders to identify concerns
    - Where reasonable, implementing changes that directly address those concerns within the company's compensation program

Glass Lewis 2020 Compensation Policy Updates (cont.)

- Contractual Payments
  - In evaluating say-on-pay proposals, generally disfavors contractual agreements that excessively favor an executive, including:
    - Excessive severance payments
    - New or renewed single trigger change-in-control arrangements
    - Excise tax gross-ups
    - Multiyear guaranteed awards
  - Also disfavors the extension of such entitlements through renewed or revised employment agreements
- Other Compensation Matters – Clarifications in Policy
  - Will review any significant changes or modifications, including post–fiscal year-end changes and one-time awards, particularly where the changes touch upon issues that are material to Glass Lewis recommendations
  - If a company has lowered short-term incentive plan performance targets midyear, Glass Lewis expects the company to provide a robust discussion of why such decision was necessary
  - Excessively broad definitions of "change in control" in employment agreements are potentially problematic as they may lead to situations where executives receive additional compensation where no meaningful change in status or duties has occurred

ISS Updates for 2020 – Shareholder Rights & Problematic Governance Practices

- Restrictions on Shareholders' Rights:
  - ISS will oppose management proposals seeking to approve or ratify requirements that are in excess of Rule 14a-8 requirements
  - ISS will recommend vote against or withhold from members of the governance committee if the company's bylaws impose what ISS considers "undue restrictions" on shareholders' ability to amend the bylaws, even if such restrictions have been approved by the company's shareholders
- Newly Public Companies and Problematic Governance Structure:
  - ISS generally will recommend a vote against or withhold from directors and boards of newly listed companies that have imposed, without sunsets:
    - Supermajority vote requirements to amend the organizational documents of the company
    - A classified board structure
    - Other "egregious" provisions
  - ISS will generally recommend a vote against or withhold from directors and boards of newly public companies with a multiclass capital structure in which the classes have unequal voting rights that are not subject to a reasonable time-based sunset
    - When determining the reasonableness of a sunset period, ISS will assess a company's lifespan, its post-IPO ownership structure and the board's disclosed rationale
    - Sunsets expiring more than seven years from the date of the IPO are de facto considered unreasonable

QUESTIONS?

For more information on Hot Topics . . .

- Join us on March 24 for a webinar exclusively focused on addressing **top-of-mind employee benefits questions for employers**
  - Register on our events page: https://www.morganlewis.com/our-thinking/events

- Check out our dedicated Trending Topics pages
  - https://www.morganlewis.com/our-thinking/trending-topics
    - **Coronavirus COVID-19**: Addressing Today's Crisis, Tomorrow's Legal Challenges
    - **SECURE Act**: Updates and Developments

THANK YOU

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