EMPLOYEE BENEFITS DEVELOPMENTS JULY 2016

Hodgson Russ Newsletter
July 28, 2016

Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Practices & Industries

Employee Benefits

RULINGS, ETC.

IRS Issues Proposed Regulations Under Section 409A. Section 409A of the Internal Revenue Code ("Section 409A") generally provides that, if a plan providing for deferred compensation fails to comply with Section 409A, either in form or in operation, then all amounts deferred under the plan are includible in the applicable service provider's income to the extent vested and not previously included in income, a 20% additional tax applies, and premium interest may be owed. In order to comply with Section 409A, a plan must comply with Section 409A's rules regarding the timing of deferral elections (including elections as to the time and form of payment) and requirements that distributions be made only upon a Section 409A permissible payment event.

The Treasury Department issued final regulations under Section 409A in 2007. Recently, the Treasury Department published proposed regulations under Section 409A that clarify and modify the Section 409A final regulations in certain respects.

The discussion below summarizes some of the more significant modifications made by the proposed regulations.

Section 409A Exemptions

Short-Term Deferral Exemption

An amount that is paid no later than two and one-half months following the later of an employee's or employer's taxable year in which the employee vests in the amount is exempt from Section 409A. Under the current rules, an amount that would otherwise qualify as a "short-term deferral" will not be considered deferred compensation subject to Section 409A if payment is delayed because (i) making the payment by the end of applicable two and one-half month period is administratively impracticable, (ii) making the payment by the end of the applicable two and one-half month period would jeopardize the employer's ability to continue as a going concern, or (iii) the employer reasonably anticipates that the payment would not be deductible due to Section 162(m) of the Code. The proposed regulations modify the short-term deferral exemption to also permit payment to be delayed if an employer reasonably anticipates that making the payment by the end of the applicable two

and one-half month period would violate Federal securities law or other applicable law.

Stock Rights Exemption

Stock options and stock appreciation rights ("SARs") (collectively "Stock Rights") that are granted with respect to "service recipient stock" are generally exempt from Section 409A. Service recipient stock does not include stock that is subject to a mandatory repurchase obligation (other than a right of first refusal) or a permanent call right if the repurchase price is based on a measure other than fair market value. Employers sometimes wish to include provisions in agreements that, if an employee is terminated for cause or the employee violates a negative covenant, the stock will be repurchased at an amount less than fair market value. The proposed regulations provide that the stock rights exemption remains available when using a measurement other than fair market value when repurchasing stock in connection with an employee's termination for cause or violation of a noncompete or non-solicitation covenant.

The Section 409A final regulations provide that service recipient stock must be common stock of a corporation that is an "eligible issuer service recipient stock." An eligible issuer of service recipient stock is defined as the corporation or certain other affiliated entities for which the employee provides direct services on the date a stock right is granted. The requirement that an employee be providing direct services on the date a stock right is granted was viewed by some as hindering negotiations with new employees. In response, the proposed regulations provide that the stock rights exemption is available with respect to a prospective employee if it is reasonably anticipated that the prospective employee will begin performing services within 12 months from the date the stock right is granted, and the prospective employee actually begins providing services within that 12-month period.

Separation Pay Exemption

Under the Section 409A final regulations, separation pay that is payable on an involuntary termination or pursuant to a window program may be exempt from Section 409A. To be exempt, the separation pay amount may not exceed two times the lesser of (i) the employee's annualized compensation for the immediately preceding year, or (ii) the Code Section 401 (a)(17) compensation limit for the year in which the employee separates from service. Questions arose regarding whether the separation pay exemption was available with respect to an employee who both began and terminated employment during the same taxable year because the employee did not have compensation for the immediately preceding year. In response, the proposed regulations clarify that the separation pay exemption is available for employees whose employment both begins and ends in the same taxable year. In that circumstance, the employee's annualized compensation for the year the employee separates from service is used in lieu of annualized compensation for the immediately preceding year.

Reimbursements Exemption

It is common that employment agreements provide for reimbursement of attorneys' fees and expenses. The Section 409A final regulations provide an exemption for attorneys' fees and other expenses incurred by an employee related to bona fide claims based on wrongful termination, employment discrimination, the Fair Labor Standards Act, or workers' compensation statutes. The proposed regulations expand the exemption to include reimbursement of attorneys' fees and other expenses for any bona fide claim by the employee against the employer with respect to the employment relationship.

Transaction-Based Compensation

The Section 409A final regulations provide special rules for transaction-based compensation related to certain changes in control that is calculated by reference to value of employer stock. In particular, transaction-based compensation can generally be paid to an employee at the same time and on the same terms and conditions as the seller in the change in control, provided that no payment may be made later than 5 years after the change in control. The proposed regulations provide that the cash out of a stock right or incentive stock option in this same manner will not cause the stock right or incentive stock option to be considered deferred compensation subject to Section 409A. However, the proposed regulations do not address the conversion of stock rights into other forms of compensation (e.g., restricted stock units or restricted stock) in connection with a change in control.

Section 409A Deferred Compensation

Distribution Timing on Death

Amounts that represent deferred compensation for purposes of Section 409A must generally be paid (or begin to be paid) within a relatively short period of time following the payment trigger event. Issues sometimes arise when the payment trigger under a plan is death, and, for example, an estate cannot be opened in time for a payment to be made in compliance with the timing requirements under the plan and Section 409A. The proposed regulations relax the timing requirements for amounts that become payable by reason of death. For this purpose, the proposed regulations provide that an amount that becomes payable by reason of a participant or beneficiary's death will be treated as timely paid if paid on or before December 31 of the first calendar year following the calendar year during which the death occurs. In addition, the recipient may be permitted to designate the taxable year in which the payment is made without violating Section 409A. However, the rules regarding constructive receipt may be implicated if a recipient is permitted to designate which taxable year a payment will be made.

Ability to Accelerate Payments to Beneficiaries

With certain limited exceptions, the time of payment for amounts representing deferred compensation cannot be accelerated without violating Section 409A. The addition of a payment event is generally considered an impermissible acceleration. However, the Section 409A final regulations allow the addition of a participant's (but not a beneficiary's) death, disability, or unforeseeable emergency as an earlier payment event at anytime. The proposed regulations provide that the exception allowing the addition of death, disability, or unforeseeable emergency as an earlier payment event also applies with respect to beneficiaries. In addition, the proposed regulations permit amounts under a deferred compensation plan to be accelerated on account of a beneficiary's death, disability, or unforeseeable emergency.

Correction of Unvested Amounts

In 2008, the Treasury Department and IRS issued proposed regulations under Section 409A that include rules regarding the inclusion of amounts in income under Section 409A. The 2008 proposed regulations permit plan provisions that are not compliant with Section 409A to be corrected without triggering any Section 409A taxes prior to the year amounts under the plan become vested. The new proposed regulations tighten existing anti-abuse rules by requiring that (i) there must be a reasonable, good faith basis to conclude that the original plan provision did not comply with Section 409A, (ii) there be no

pattern or practice of permitting impermissible changes in the time or form of payment with respect to nonvested amounts, (iii) the correction should be consistent with IRS correction methods set forth in published guidance, and (iv) substantially similar failures must be corrected in a consistent manner.

Effective Date

The proposed regulations provide that taxpayers may rely on the proposed regulations effective immediately.

DOL Increases ERISA Civil Monetary Penalties. ERISA violations just got more expensive. In June, as part of an effort by the federal government to overhaul outdated civil penalties, the U.S. Department of Labor (the "DOL") issued an interim final rule (*see* 81 Fed. Reg. 43429) to adjust for inflation the civil penalties assessed or enforceable by the DOL. The adjustments to the DOL's civil penalties include increases to the civil monetary penalties enforced by the Employee Benefits Security Administration (EBSA) under the Employee Retirement Income Security Act of 1974 (ERISA).

The penalty increases are being made to meet the requirements of the Federal Civil Monetary Penalties Inflation Adjustment Act Improvements Act of 2015 (the "2015 Inflation Adjustment Act"). By no later than July 1, 2016, the 2015 Inflation Adjustment Act required the DOL to make a "catch-up" adjustment to ERISA civil monetary penalties enforced by EBSA, for inflation through October of 2015.

In the case of ERISA violations that occurred *after* November 2, 2015 for which penalties are assessed *after* August 1, 2016, the DOL's "catch-up" adjustment to the ERISA civil monetary penalties will apply. For violations that occurred *before* November 2, 2015, and for violations that occurred *after* November 2, 2015 for which penalties are assessed *before* August 1, 2016, the penalty adjustments required by the 2015 Inflation Adjustment Act will *not* apply.

Beginning in 2017, the DOL will further adjust the ERISA civil penalty amounts for inflation on an annual basis. The adjustments will be made no later than January 15 of each year.

Some of the "catch-up" adjustments to ERISA civil monetary penalties include:

ERISA Violation

-

Current Penalty Amount

Adjusted Penalty Amount

Failure to furnish reports (e.g., pension benefit statements) to certain former participants and beneficiaries, or maintain records

Up to $11 per employee

Up to $28 per employee

Failure or refusal to file the Form 5500

or

Failure of a multiemployer plan to certify endangered or critical status that is treated as a failure to file annual report

Up to $1,100 per day

Up to $2,063 per day

Failure to provide a summary of benefits and coverage

Up to $1,000 per day

Up to $1,087 per day

Failure to provide required automatic contribution arrangement notices

Up to $1,000 per day

Up to $1,632 per day

Failure to provide blackout notices or notices of diversification rights

Up to $100 per day

Up to $131 per day

Failure to furnish information requested by the Secretary of Labor

Up to $110 per day not to exceed $1,110 per request

Up to $147 per day not to exceed $1,472 per request

Failure of multiple employer welfare arrangement to satisfy applicable filing requirements

Up to $1,100 per day

Up to $1,502 per day

For a more complete listing of the 2015 Inflation Adjustment Act "catch-up" adjustments to ERISA civil monetary penalties, see the Fact Sheet published by the DOL at https://www.dol.gov/ebsa/pdf/fs-interim-final-rule-adjusting-erisa-civil-monetary-penalties-for-inflation.pdf.

IRS Issues Memo on Taxation of Wellness Program Rewards. The IRS recently issued a Chief Counsel Advice memorandum addressing the tax treatment of wellness program benefits. Wellness programs come in many shapes and sizes,

but a common feature shared among all wellness programs is that they promote employee health. Besides the obvious benefit this provides employees, promoting a healthy workforce also benefits employers by reducing absenteeism and reducing costs associated with health plans. Wellness programs are typically designed to incentivize participants by rewarding them when they engage in certain healthy activities. In this memo, the IRS confirms that although the coverage provided under the wellness programs is excluded from income, any cash or payment of gym membership fees offered as rewards under the programs should be treated as taxable income to participants. This includes cash provided to employees as "reimbursements" of all or a portion of any required pre-tax employee salary reduction contributions to a wellness plan. If you are considering a wellness program design that purports to give participants cash rewards that are not subject to tax, you are encouraged to discuss such a design with your employee benefit attorney or tax advisor. (C.C.A. 2016–04–014 (April 14, 2016))

EEOC Publishes Sample Wellness Plan Employee Notice. In May, the Equal Employment Opportunity Commission (EEOC) issued final regulations detailing the rules that apply to employer-sponsored wellness programs that collect employee health information such as, for example, through health risk assessments and biometric testing. The regulations are designed to ensure that employer-sponsored wellness programs are maintained in compliance with the Americans with Disabilities Act (ADA) and the Genetic Information Nondiscrimination Act (GINA). As noted in our June newsletter (available here: http://www.hodgsonruss.com/newsroom-publications-employee-benefits-developments-June-2016.html) these rules are scheduled to take effect for plan years beginning on or after Jan. 1, 2017.

The final rules require employers to provide a notice to employees informing them of the health information that will be collected; who will receive it; how the information will be used; and how the privacy of that information will be protected. In June, the EEOC published guidance regarding the notice requirement, and issued a sample notice that employers may use as a template. The notice can be found here: https://www.eeoc.gov/laws/regulations/ada-wellness-notice.cfm. The FAQs can be found here: https://www.eeoc.gov/laws/regulations/qanda-ada-wellness-notice.cfm.

The requirement to provide the notice takes effect as of the first day of the plan year that begins on or after January 1, 2017, and must be provided to employees. Spouses must receive a notice if their health information is requested as part of the program. Notice must be provided before the employees (and, if applicable, their spouses) provide the requested health information, and with enough time to decide whether to participate in the wellness program. Employers may use their own notice in lieu of the EEOC template, but must take care to ensure that the individually designed notice meets all applicable requirements.

CASES

Court Upholds Denial of Severance Benefits in Connection with Change of Control. Under a recent district court ruling, a company manager who initially continued in his position with a successor employer following a sale of his division is not entitled to severance benefits under his former employer's severance plan (the "Severance Plan"), despite the manager's termination by his new employer shortly after the change of control. As a participant in the Severance Plan, the manager would have been entitled to 59 weeks of severance from his former employer had he been determined to have been "involuntarily terminated" at the time of the sale.

The business division that employed the manager was sold in an asset deal on April 14, 2014. In connection with the sale, the manager accepted continued employment with the buyer in the same position that he had held with the seller and under terms and conditions that were nearly identical. Nine days later, the manager was terminated by his new employer. The asset purchase agreement provided that former employees of the seller who were later terminated by the buyer would receive severance benefits consistent with the terms of the buyer's own severance policies, but would be given credit for prior periods of service with the seller. Accordingly, the manager was offered and accepted severance benefits from the buyer, entering into a separation and release agreement under which he would receive 16 weeks of base salary and employer provided health insurance for a period of time. The agreement also contained release language that included the manager's agreement to release the buyer and all of its predecessors from all claims relating to employee benefits and the termination of his employment.

Following his termination by the buyer, the manager filed a claim with the seller for benefits under the seller's Severance Plan, alleging that the seller involuntarily terminated his employment when it closed on the sale, and claiming 59 weeks of base pay, 12 weeks of subsidized COBRA benefits, acceleration of performance bonuses, and two years of outplacement services. The seller denied the manager's claim, on the basis that, because he accepted continuing employment that was indistinguishable from his employment with the seller, he suffered no period of unemployment and was therefore not involuntarily terminated by the seller at the time of the sale. The seller also pointed to the protection offered by the purchase agreement under which employees would receive credit for prior years of service should they be terminated by the buyer.

Following denial of his claims appeal, the manager sued the seller for breach of its fiduciary duties under ERISA for failing to pay him severance benefits under the Severance Plan. Because the plan language grants discretionary authority to the plan administrator to interpret the terms and eligibility provisions of the Severance Plan, the court employed the "abuse of discretion" standard of review, ultimately ruling that the plan administrator's decision to deny benefits to the manager was reasonable. The court held that because the term "involuntarily terminated" is not defined in the Severance Plan, the plan administrator and the benefit administration committee "have the exclusive authority to interpret its meaning," concluding that their interpretation was not an abuse of discretion where they considered that the manager's role before and after the sale was the same, his employment continued uninterrupted, and he experienced no change in his base compensation or benefit entitlement. The court also noted that even if it were an abuse of discretion for the plan administrator to interpret the term "involuntarily terminated" as requiring a period of unemployment to be eligible for benefits under the Severance Plan, the manager released any claim for severance benefits when he signed a release that released his employer and any of its predecessors from any and all claims arising out or relating to the cessation of his employment, including claims for employment benefits and causes of action under ERISA. Accordingly, the court granted summary judgment to the Severance Plan and the seller. From an employer's perspective, this case illustrates the importance of including language in severance plans granting discretionary authority to plan administrators to interpret the terms of the plan and determine eligibility for benefits, and of obtaining releases of claims from employees at the time of termination. *Vickery v. ConAgra Foods, Inc.* (E.D. Mo., 2016)

Company Avoids Withdrawal Liability Assessment Under Trucking Industry Exception. Penske Logistics LLC and Penske Truck Leasing Co., LLP (Penske) were engaged in business operations which included trucking services and truck leasing. For a period of time, Penske owned Leaseway Motorcar Transport Company which was engaged in the long and

short haul trucking industry. In 2004, Penske transferred ownership of Leaseway to a third-party Performance Transportation Company. Two years after the transfer, Leaseway and various affiliates filed for Chapter 11 bankruptcy protection. As a result of the bankruptcy proceeding, Leaseway ceased making contributions to a multiemployer pension plan which was a trucking industry fund. The Fund assessed complete withdrawal liability against Penske of $3.9 million. In 2012, an arbitrator dismissed the Fund's demand against Penske.

Over the years, this case has had various issues decided by several courts. In this most recent case, the primary issue remaining was whether the arbitrator correctly interpreted ERISA § 4203(b) which states that for the trucking industry exception to withdrawal liability to apply, the employer cannot continue to perform work "within the jurisdiction" of that fund. The Fund argued that jurisdiction of the fund meant geographic jurisdiction; Penske was engaged in operations across the country. The arbitrator disagreed with the Fund finding that jurisdiction of the fund meant the type of work for which contributions would have been required to be made the Fund (long and short haul trucking). The work that Penske continued to perform, while within the geographic area, was not of the type of work that would have required contributions to be made to this Fund. On appeal, the District Court for Maryland agreed with Penske and upheld the arbitrator's decision that jurisdiction for purposes of the trucking industry exception was not a geographic description; rather it describes the type of work that requires contributions be made to a fund. *Freight Drivers & Helpers Local Union No. 557 Pension Fund v. Penske Logistics LLC*, D. Md., 2016.