



Survey of Current Benefits Issues

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Affordable Care Act





Affordable Care Act: Fees and Taxes

2015 – Employer Shared Responsibility Fee

- The employer shared responsibility fee is to encourage employers to offer health coverage or pay an amount to subsidize coverage through an exchange
- Two penalties:
- Big penalty
 - If employer does not offer minimum essential coverage (“MEC”) to 95% of full-time employees (“FTs”); and
 - 1 employee enrolls on exchange and receives subsidy
 - Penalty is \$2,000 x (number of employees – 30)
- Not as big penalty
 - If employer does offer MEC to at least 95% of FTs, but coverage is not both (a) minimum value, and (b) affordable; and
 - 1 employee enrolls on exchange and receives subsidy
 - \$3,000 x number of employees who go to the exchange for coverage and qualify for premium subsidy or cost sharing
 - Capped at big penalty



Fees and Taxes

2015 – Employer-Shared Responsibility Fee

- Big Fee: \$2,000 multiplied by all employees
 - 530 employees equals \$1 million in fees
- Smaller Fee: \$3,000 per employee
 - 33 employees equals \$100,000 in fees



Fees and Taxes

2015 – Employer Shared Responsibility Fee

- Fee applies to employers with 50 or more full-time equivalent employees (FTEs)
 - Part-time employees are used to determine if employer is covered (even though penalty not due on employees working less than 30 hours)
- Fee assessed on FTs (not FTEs) – employees working 30 hours a week or more
- Employee means a common law employee
 - Guidance indicates employee includes (or may include)
 - Long-term leased employees
 - Independent contractors
 - Interns
 - Seasonal employees
 - Temporary employees
 - An employer may not owe an employer shared fee on all of these workers, but should review



Fees and Taxes

2015 – Employer Shared Responsibility Fee

- Fee is assessed on a month-by-month basis
 - Two methods of measuring
 - Monthly method
 - Look-back method
 - Both methods require hour counting
- Hour counting
 - Actual hours for hourly employees
 - Equivalency for exempt employees
 - 8 hours if employee works during day
 - 40 hours if employee works during week
 - Need to count on-call and other hours
- Nature of employees will drive method and coverage
 - If employer has lots of variable hour employees, may use look-back
 - If employer has interns, may offer them coverage
 - If employer has part-time exempt, may offer them coverage



Fees and Taxes

2015 – Employer Shared Responsibility Fee

- 2015 transition relief
- Employers with 50 but less than 100 full-time employees
 - For 2015, these employers will not be subject to fee
 - May not reduce workforce or overall hours before 12/31/14 (other than for bona fide business reasons)
 - May not reduce or eliminate coverage before 12/31/14
 - Must certify eligibility under section 6056
- Coverage percentage
 - For 2015, section 4980H(a) will not apply if employer covers at least 70% of full-time employees (rather than 95%, which starts in 2016)
 - Note: The not as big penalty (section 4980H(b)) still applies
- Calculation of the big penalty
 - For 2015, section 4980H(a) will have an exclusion for 80 employees rather than 30 employees



Fees and Taxes

2015 – Employer Shared Responsibility Fee

- Steps an employer should take:
- Review employer controlled group
 - Are there other related employers?
- Review workforce
 - Identify categories of workers
 - Consider interns, temp employees, leased employees, independent contractors
- Review coverage
 - Which employees are covered?
 - Are children covered?
- Review value and affordability
 - Does employer pay at least 60% of cost?
 - Does coverage cost any employee more than 9.5% of pay?
- Determine measurement method (monthly vs. look-back)
 - If employer has significant part-time employees or seasonal employees, may wish to use look-back method
 - If not, monthly method may be simpler



Fees and Taxes

- Patient Centered Outcomes Research Fee (2012)
 - \$2 per covered life for plan years ending on and after 10/1/13 through 9/30/14
 - Fee indexed for plan years beginning after 9/30/14
- Transition Reinsurance Fee (2016)
 - \$63 per covered life
- Cadillac Tax (2018)
 - 40% Penalty
- 3.8% Medicare Tax
 - Assessed on Net Investment Income
 - For filers above the modified adjusted gross income thresholds
 - \$200,000 for single filers, \$250,000 for joint filers
- 0.9% Medicare Tax
 - Increases Medicare tax rate from 1.45% to 2.35% on employees earning more than \$200,000
 - IRC Sec. 3102(f)



Forms for Reporting Fees

- To assess fees, the federal government needs information – that means employers (and / or insurers) need to submit forms
- Form for 6055 (minimum essential coverage) – Form 1094 and Form 1095
- Form for 6056 (whether employer offered coverage) – Form 1094 and Form 1095
- Form for 4375-77(PCOR fee) – Form 720
- Form W-2 – Value of health benefits (may be used in future for Cadillac tax)



Retirement Plan Errors



Retirement Plan Errors

Overview

- Types of errors
 - Eligibility
 - Vesting
 - Compensation
 - Loans
- Correction procedures – EPCRS

Retirement Plan Errors

Eligibility

- Plan document list of eligible employees
 - Review plan's list of eligible employees against your employment practices
 - Are there any individuals employed who are not excluded under the plan's list of excluded employees?
 - For example:
 - Leased employees
 - Temporary employees
- Part-time employees
 - Plans cannot exclude part-time employees as a group
- Automatic enrollment
 - Are eligible employees not being enrolled?
- Re-hired employees
 - Review practices with respect to re-hires and counting prior service toward eligibility

Retirement Plan Errors

Vesting Errors

- Crediting of one-year of vesting service
 - Review when employee is credited with one year of vesting service
 - An employee earns a year of vesting service upon completing 1,000 hours – not at the end of the 12-month period
- Changes in employee classification
 - Review employees moving from an ineligible to eligible classification
 - If an employee is ineligible and becomes eligible, the employee's service in the ineligible classification counts for purposes of vesting
- Exempt employee hours
 - Review how exempt employee hours are calculated
 - Is the employer tracking actual hours or using an equivalency (such as 190 hours if 1 hour is worked in a month)?
- Re-hired employees and transfers
 - Does the employer track prior service of re-hire?
 - Does the employer track employees who move from a related entity?

Retirement Plan Errors

Compensation

- Definition of compensation where there are multiple plans
 - If the employer has more than one defined contribution plan, review whether compensation is defined in the same manner for all plans
 - Example: One plan uses W-2 definition of compensation and the other plan uses wages under Section 3401(a)
- Different definition of compensation
 - Review whether the definition of compensation is the same for employer and employee contributions
 - If the definitions are different, is compensation correctly calculated for each type of contribution?
- Contributions to the plan
 - Review whether elective contributions are being deducted from severance pay (this is not permitted)
 - Review whether elective contributions are taken from off-cycle pay (paychecks or bonuses)

Retirement Plan Errors

Loans

- Loans
 - Review the rate of interest required under the plan
 - Is it a reasonable rate of interest (what employee would be charged at a bank)?
 - Does the rate in the plan match the amount being charged in operation?
 - Review how loans are handled when an employee is on a leave
 - Does the plan reamortize the loan or require the loan to be caught up?
 - If the employer has more than one plan that allows loans, review whether the plans coordinate to assure that loans to an employee do not exceed the loan limits

Retirement Plan Errors

IRS Correction Process

- The Employee Plans Compliance Resolution System (EPCRS) contains the IRS guidance on how to correct errors
 - Levels of correction
 - Self Correction Program (SCP)
 - No submission to IRS (but no confirmation)
 - No fee
 - Voluntary Compliance Program (VCP)
 - Submission to IRS
 - Fee (based upon number of participants)
 - Audit CAP (Closing Agreement Program)
 - IRS discovers error upon audit
 - Sanctions based upon facts and circumstances and Maximum Payment Amount (MPA)



Equity Compensation



Equity Compensation

- Employee ownership is often driven by retention needs, as opposed to succession planning, but both factors can come into play
- If your company's compensation consists only of cash you may discover that your existing employees or a candidate that you are seeking to hire may accept an offer for a similar position with a competing company that offers equity in addition to cash compensation

Equity Compensation

- Issues private companies should consider before adopting an equity compensation program:
 - Impact on corporate governance
 - Liquidity (exit opportunity)
 - Compliance with securities and tax laws

Equity Compensation

- Impact on corporate governance:
 - Sharing financial information with employees
 - Voting and dissenters' rights
 - Treatment of terminated employees
 - Repurchase Rights

Equity Compensation

- Liquidity (exit opportunity):
 - Generally no market exists for shares absent sale or similar liquidity event
 - Limitations on transfer rights (both by operation of law and/or shareholder agreement)
 - Company may be hesitant to offer put rights short of a sale situation
 - Cash flow issue

Equity Compensation

- Compliance with securities and tax laws:
 - Registration and disclosure requirements
 - Re-sale limitations
 - Taxation considerations:
 - Partnerships and LLC structures raise significant tax issues for employee owners
 - Ordinary income vs. capital gain
 - Tax withholding requirements often impose significant burdens on private companies
 - Reporting issues—ex. Form 3921 for ISO exercises

Equity Compensation

- Is there a preferred form of equity compensation?
 - Options and SARs remain popular because they offer significant flexibility on timing of taxation
 - Option pricing is critical
 - Restricted stock remains popular for start-up situations; significant capital gain opportunity (83(b) election)
 - Phantom stock is popular for family-owned companies that want to incentivize employees with economic benefits but not participatory/voting rights
 - Pays based on the appreciation in the value of the company
 - Streamlined compliance—payments are W-2 income
 - Downside—no opportunity for capital gain or sense of ownership

Incentive Stock Options

- Main ISO Requirements
 - Only may be granted to employees
 - Must be granted at 100% of FMV on date of grant (110% if awarded to a 10% shareholder by voting power)
 - Limited to 10 year term (5 years if to a 10% shareholder)
 - Equity plan must state plan limit for ISOs
 - Only \$100,000 in value per calendar year (that vests for the first time in that year) will qualify as ISOs (measured by the grant date value)
 - ISOs may not have post-termination exercise period longer than 3 months

ISO Taxation (General Case)

- Not taxed on date of grant
- Not taxed upon vesting
- No federal or employment taxes payable or withheld on date of exercise (but see annual reporting obligation discussed later)
- If holding periods met:
 - Sale at least 2 years following date of grant
 - Sale at least 1 year following date of exercise
 - Then participant will have long term capital gains treatment upon sale of shares
- If holding periods not met, a “disqualifying disposition” occurs
 - Results in ordinary income measured by the spread at the original time of exercise, included in the year of the disqualifying disposition
 - Example: Granted in Year 1 at \$10, Exercised in Year 2 at \$20, Sold in Year 3 at \$30 (but 2 year holding period not met).
- No compensation deduction to employer if holding periods met

Any Advantages to Early Exercise ISOs?

- Recap
 - Allows participants to exercise ISOs immediately and receive back restricted stock subject to same vesting schedule
- No taxation at grant or vesting (although full amount is exercisable in year 1 for purposes of \$100,000 limit)
- No taxation when ISO is exercised
- Also no taxation when underlying restricted stock vests
- If holding periods met, taxed identically compared to standard ISOs—long term capital gains rates in year of sale of underlying stock
- Possible advantage as it allows you to accelerate the one year from date of exercise holding period

Any Advantages to Early Exercise ISOs?

- Alternative Minimum Tax (Without an 83(b) Election)
 - You can exercise when there is little or no spread, but will continue to recognize additional AMT upon vesting of restricted stock equal to the spread at the time of vesting.
 - If ISO becomes disqualified...
 - Spread at exercise not taxed at compensation rates—instead ordinary income based on lower of (i) value of spread when shares vested or (ii) actual gain at sale

ISO Reporting

- Required annually on Form 3921 for any ISO exercises in prior calendar year
- Information sent to optionee as well as IRS
- Captures information such as grant date, exercise date, FMV on date of grant and date of exercise
- Deadline to send to optionee coincides with deadline to send W-2s at end of January

Nonqualified Stock Options (NQSOs)

- Not taxed at grant or vesting
- Taxed at exercise and subject to compensation taxation and withholding on the spread
- To be exempt from 409A, must be granted at 100% FMV on grant date
- Exercise date starts holding period for capital gains purposes
- If early exercise permitted (without an 83(b) election):
 - Will be little or no spread at exercise—would be compensation income
 - Will be additional compensation income when underlying restricted stock vests
 - Great structure for startup companies

Nonqualified Stock Options (NQSOs)

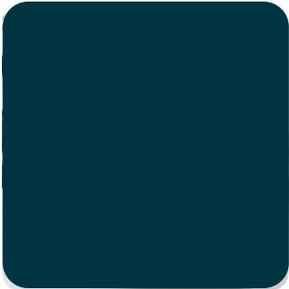
- If timely 83(b) election made following an early exercise:
 - Any spread at time of exercise will be compensation income subject to income and employment tax withholding
 - No further compensation income recognized when underlying restricted stock vests

Restricted Stock

- Not taxed at grant
- Taxed based on value at time of vesting
 - Compensation income subject to employment and income tax withholding
- Any further appreciation will be capital gains when sold
- If 83(b) election filed timely (within 30 days following grant)
 - Taxed as compensation income based on FMV on date of grant minus any amount paid for the shares
 - No further compensation income when shares vest
 - But, no guarantee that shares will have value when sold or will not be forfeited (such as if terminated prior to vesting)
- Exempt from Section 409A

Restricted Stock Units

- Not taxed at time of grant
- Not taxed when vested
- Taxed as compensation when shares paid
- Not automatically exempt from 409A
 - May be exempt under short term deferral rule or 2X pay exception
 - May need to comply with 409A
 - For example, paid upon specified date or change in control
 - No need for 6 month delay for separation payments to key employees of private company



Section 409A



Overview – Section 409A

- Section 409A defines deferred compensation as a “legally binding right” to compensation in one year that is to be paid or could be paid in a later year
- Section 409A is very broad and extends beyond what is traditionally thought of as deferred compensation
- Section 409A places restrictions on the timing of elections/decisions to defer compensation
- Section 409A restricts the timing of payment to one or more of 6 permitted payment triggers: Death, Disability, Change in Control, Unforeseeable Emergency, Separation from Service, and specified payment date or payment schedule
- Failure to comply results in immediate inclusion in income and a 20% penalty tax
- Applies to executives, directors, independent contractors, partners, and employees

Overview – Section 409A

- Arrangements subject to or potentially subject to section 409A
 - Deferred compensation plans
 - SERPs, excess plans, elective deferral plans, 457(f) plans, etc.
 - Bonuses
 - Short-term and long-term incentive plans
 - Severance (voluntary and involuntary) arrangements
 - Change in control plans
 - Retention plans
 - Employment agreements with severance, CIC, or other provisions
 - Equity-based plans and awards
 - Stock options, SARs, restricted stock units, and phantom stock

Overview – Section 409A

Taxes, penalties, and scope

- Taxes and penalties
 - Immediate inclusion of deferral amount in income
 - Increased by a 20% tax (penalty) and, if the amount is not included in income in proper year, interest from the year it should have been included in income
 - Tax is imposed on the executive, not the company; the company has reporting and withholding obligations
- Scope
 - Applies to executives, directors, independent contractors, and employees
- There are several other exemptions that could apply

Separation Pay and 409A

- Separation Pay can arise under:
 - A negotiated departure agreement where there was no prior right to severance; or
 - A severance plan or agreement (including employment agreement that provides severance rights)

Separation Pay and 409A

- Compliance with 409A – two main ways:
 - Design plan or agreement to avoid 409A by structuring payments to meet a 409A exception. Examples:
 - Short term deferral exception
 - Two times pay safe harbor exception
 - Structure plan or agreement to comply with rules under 409A

Separation Pay and 409A

- Section 409A has a number of exemptions for payments made upon termination, including:
 - Involuntary termination (including good reason) provided paid within short term deferral period
 - Involuntary termination provided amount limited to lesser of two times pay or Code limit (\$520,000 in 2014) and paid no later than end of second year following year in which termination occurs (the “two times pay safe harbor exclusion”)

Separation Pay and 409A

- Short Term Deferral (STD) Exception
 - Payments made not later than 2 ½ months after the end of the year in which substantial risk of forfeiture (SRF) lapses are not 409A deferred compensation
 - Careful about what is an SRF – involuntary separation is; good reason separation may be; covenant not to compete is not.
 - Where contract provides for separation pay on voluntary quit, will never meet STD exception

Separation Pay and 409A

- Two time pay safe harbor exception
 - Paid only on involuntary termination (including safe harbor good reason)
 - Does not exceed, in the aggregate, lesser of:
 - Twice EEs annualized comp for prior year or
 - Twice the comp limit under 401(a)(17) (limit is \$260,000 for 2009), so twice the limit is \$520,000 for 2014)
 - Paid in full by end of second year following separation from service

Separation Pay and 409A

- More than one exception may apply
 - Some payments may be under STD exception
 - Some payments may be under Two Times Pay Safe Harbor Exception
 - Some payments may be subject to 409A and structured to comply

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