

Motivating and Compensating Employees in Uncertain Times

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Moderator

Agenda

Topic	Speaker
Compensation plan changes	Mark Jones
Equity awards, including LOA and furloughs	Jessica Lutrin
Retirement program loans & distributions	Marcus Wu
Health and welfare program changes	Marcus Wu
Tax credits & deferrals	Keith Ranta

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Compensation Plan Changes

Compensation Plan Changes: Incentive Plans

- Incentive Plans: Keep, delay or amend
- Keep original performance targets and metrics in place
 - Balance need for retention against shareholder expectations
 - Financial targets set at the beginning of the year are likely to be impossible to reach
 - Institutional shareholders still expected to focus on TSR
 - Overhang of shares that will never vest
 - Avoids jeopardizing say on pay
 - Avoids jeopardizing accounting treatment
 - Avoids jeopardizing 162(m) grandfathering

Compensation Plan Changes: Incentive Plans

- Delay
 - Expectation that market will have less volatility in the future and impact of pandemic more certain
 - Plan must permit setting targets after the first quarter
 - Plan drafted to be exempt from 162(m) may require targets be set within the first 90 days
 - May be more palatable for long-term than short-term incentive
 - Negative tax and accounting impacts if achievement of target is substantially certain
 - Institutional shareholders do not like short performance periods
 - If targets have already been approved:
 - May introduce new targets as separate award (consider dilution)
 - May terminate original plan and introduce new targets as replacement
 - For equity-based plans, may stagger offerings over the year

Compensation Plan Changes: Incentive Plans

- Amending targets or metrics
 - Examples:
 - Reduce targets to reflect financial analysis of expected impact of Covid
 - Replace or supplement absolute targets with relative targets
 - Add individual performance targets (e.g., effectiveness of crisis response)
 - Plan must permit midyear unilateral revisions.
 - Common examples:
 - Exercise of year-end discretion
 - Exclude impact on metrics of extraordinary nonrecurring event
 - Unilateral revision permitted if no material negative impact of participant
 - Target dollar amounts for equity awards may cause high dilution if stock prices are low
 - May trigger need to increase to share pool (shareholder approval required)
 - Consider reducing the dollar target or using an extended trailing average
 - Required disclosures
 - ISS has stated that any revisions to incentive compensation for Covid must be fully explained in proxy
 - 8-K may be required if amendment to plan or NEO arrangement
 - May trigger variable accounting

Compensation Plan Changes: Deferred Compensation

- Deferred Compensation
 - Distributions
 - Not permitted on account of leave, furlough or reduction of hours
 - Unforeseeable emergency
 - Must be permitted in plan
 - Extraordinary and unforeseeable circumstances beyond the control of the participant
 - Limited to amount reasonably necessary to satisfy emergency need
 - Severe financial hardship that cannot be relieved through other means, including insurance and liquidation of assets
 - Illness or accident of participant, spouse, beneficiary, or dependent
 - Medical or funeral expenses of the participant's spouse, beneficiary, or dependent

Compensation Plan Changes: Deferred Compensation

- Cancellation of deferral election
 - Must be permitted in plan
 - Unforeseeable emergency
 - Hardship withdrawal under qualified plan
 - Broader definition of financial need
 - Specifically includes expenses related to federally declared disaster
 - Do not need to consider other sources of income

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• Jessica Lutrin

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Equity awards, including LOA and furloughs

Equity Awards: Repricings, Option Exchange Programs and Cash Buyout Programs

- Underwater option – an option with an exercise price that is less than FMV
- Repricing – unilateral amendment to reduce per share exercise price
- Option exchange program – cancellation of underwater options for options with a lower exercise price or a different type of equity (e.g., RSUs)
 - One-for-one basis or value for value-basis
 - Same or different terms as cancelled options
- Cash buyout program – purchase of underwater options by company for cash
 - Paid currently or on a deferred basis
 - Vesting conditions
- Recurring vs. once-off event

Equity Awards: Repricings, Option Exchange Programs and Cash Buyout Programs (*cont'd*)

- Tax rules
 - NSOs
 - Modification
 - Floating vs. fixed exercise price
 - ISOs
 - Concurrent grant of new option – separately evaluated
 - \$100,000 annual limit
 - Restart mandatory holding periods
- Tender offer rules
 - Private company
 - More than 10 employees
 - Public company
 - Limited relief from tender offer requirements

Equity Awards: Repricings, Option Exchange Programs and Cash Buyout Programs *(cont'd)*

- Public company rules
 - NYSE and NASDAQ shareholder approval
 - Institutional investors and proxy advisory firm guidelines
- Accounting rules
 - ASC Topic 718 – modification

Equity Awards: Extension of Post-Termination Exercise Period

- Generally, three months to exercise vested options on termination
- Obtain release of claims / act of goodwill
- Reserved for senior management
- Considerations:
 - Administrative burden
 - Capped at expiration date for NSOs
 - Conversion of ISOs to NSOs
 - Increase in tax liability
 - Shareholder dilution
 - ASC Topic 718 – modification

Equity Awards: Furloughs and Leaves of Absence

- Whether vesting should be paused
- Equity plan termination provisions
 - Administrator approval for interpretation / decisions
- Leave of absence policies
 - Paid leave of absence
- Discrimination / unfair treatment
- Tax consequences
 - Section 409A – separation from service / bona fide leave of absence
 - ISOs – three-month period

Equity Awards: Tax Withholding for Stock Awards

- Office of the Chief Counsel Memorandum (AM 2020-004)
- Change in stock price between option/SAR exercise or RSU vesting and delivery of shares
- Identifies three scenarios with publicly traded companies
- Options and SARs – income and FICA tax calculated on exercise date
- RSUs – income tax calculated on date company initiates payment

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• Marcus Wu

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Retirement, Health and Welfare

401(k) Plan—Legislation

- COVID-19 Related Key Provisions of:
 - the Setting Every Community Up for Retirement Enhancement (SECURE) Act; and
 - the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

401(k) Plan – Planning Opportunities & Requirements

- Special Plan Distribution Options:
 - In-service withdrawals for Qualified Individuals (impacted by COVID-19) of up to of \$100,000 in 2020 without income tax penalties; regular taxes apply, but recoverable by repaying withdrawal within 3 years
 - Waiver of Required Minimum Distributions (RMDs start at age 72)
- Special Plan Loan Opportunities:
 - Qualified Individuals can borrow up to \$100,000 or 100% of their accounts
 - Qualified Individuals can take an extended time period to repay outstanding loans
- Newly-Issued IRS Guidance for Increased Flexibility Regarding Spousal Consent

401(k) Plan – Cost Saving Measures

- Reduce, Suspend or Discontinue Employer Matching and/or Profit-Sharing Contributions:
 - Governance and Plan Amendment Requirements
 - Timing:
 - Communicate to participants with sufficient notice such that they can “opt-out”
 - Special notice requirements for safe harbor program – 30-day advance notice
 - Form and Content of Notice

Health and Welfare Benefits

Plan Changes	Mandatory/ Optional	Effective Date	Expiration
Covid-19 Diagnostic Testing and Related Items and Services (In-Network and Out-of-Network)	Mandatory	March 18, 2020	End of Emergency Period
Coverage of COVID-19 Treatment by HDHPs	Optional	January 1, 2020	Until further guidance is issued
COVID-19 Preventive Services and Vaccines	Mandatory	March 27, 2020	N/A (Permanent Change)
Coverage of telehealth and Remote Care Services without Cost-Sharing	Optional	Services provided on or after January 1, 2020	End of applicable plan year which began on or before December 31, 2020
Coverage of OTC Medicines and Drugs and Menstrual Products under Health FSAs and HRAs	Optional	Claims incurred on or after January 1, 2020	N/A (Permanent Change)

Health and Welfare Benefits

Plan Changes	Mandatory/ Optional	Effective Date	Expiration
Extension of HIPAA Special Enrollment Deadlines	Mandatory	March 1, 2020	End of “Outbreak Period” (60 days following the announced end of the National Emergency)
Extension of Claims and Appeals Deadlines	Mandatory	March 1, 2020	End of Outbreak Period
Extension of Deadlines to File a Request for External Review/Perfect and Incomplete Request for External Review	Mandatory	March 1, 2020	End of Outbreak Period
Extension of COBRA Election and Premium Payment Deadlines	Mandatory	March 1, 2020	End of Outbreak Period
Extension of Period to Provide Notification of a COBRA Qualifying Event or a Disability Determination	Mandatory	March 1, 2020	End of Outbreak Period

Health and Welfare Benefits

Plan Changes	Mandatory/ Optional	Effective Date	Expiration
Mid-Year Change in Status Elections	Optional	Prospective (from the date of an amendment)	December 31, 2020
Extended Deadline for Furnishing Certain Notices, Disclosures and other Documents Required under Title I of ERISA	Optional	March 1, 2020	60 days after the National Emergency Ends

Cafeteria Plans

- **Health Flexible Spending Account (FSA)**, permitting employees to receive nontaxable reimbursements for eligible medical expenses
- **Dependent Contribution Account plan (DCAP)**, permitting employees to receive nontaxable reimbursements for dependent care expenses
- **Pre-Tax Medical Premium**, enabling employees to pay premiums for health/dental/vision coverage with pre-tax deductions from their pay

Overview

- FSA: OTC and Feminine Care Products
- FSA: Mid-Year 2020 Election Changes
- FSA: Changes to Grace Period and Carryover Rules
- DCAP: Mid-Year 2020 Election Changes
- Pre-Tax Medical Premium: Mid-Year 2020 Election Changes
- Suggested Next Steps
- Other COVID-Related Guidance Affecting Health and Welfare Plans

FSA: OTC and Feminine Care Products

- The Employer's FSA may now provide nontaxable reimbursements of (i) over-the-counter (OTC) medicines and drugs without a prescription, and (ii) menstrual care products (tampon, pad, liner, cup, sponge or similar product).
- This new rule applies to expenses incurred on or after January 1, 2020.

FSA: Mid-Year 2020 Election Changes

- Generally, under the tax laws, once employees make their FSA election for a calendar year (including an election not to contribute), they cannot change the election during that year except in limited circumstances such as a change in family status (e.g., divorce, marriage, birth, etc.).
- Under the new IRS guidance, the Employer may permit employees to change—i.e., increase, decrease, or suspend—their FSA contribution election for 2020 for any reason. These mid-year elections may apply prospectively only. No refunds of FSA contributions already made in 2020 are permitted.

FSA: Changes to Grace Period and Carryover Rules

Under the tax laws, a cafeteria plan may offer a grace period or carryover, but not both.

If Employer's plan has a grace period

- Under the tax rules governing FSAs, employees who made FSA contributions for 2019 may receive reimbursements of those contributions for eligible medical expenses incurred between 1/1/19–12/31/19. If a plan offers a grace period, the last day of this expense period is extended for a few months into 2020—e.g., to 3/15/20. If the employee has unused FSA contributions as of the last day of the grace period, they are forfeited.
- Under the new IRS guidance, the Employer may permit employees who had unused 2019 FSA contributions on the last day of grace period (ending in 2020) to receive reimbursements of those amounts for medical expenses incurred through 12/31/20.

If the Employer's plan has a carryover

- Usually, employees who made FSA contributions for 2020 exceeding their reimbursable medical expenses for 2020 must forfeit the excess. Under a plan with a carryover, however, any unused amounts up to \$500 are carried over to 2021 for reimbursement of medical expenses incurred in 2021.
- Under the new IRS guidance, the Employer may increase the \$500 carryover to \$550 for 2020, enabling employees to carryover unused 2020 FSA contributions up to \$550 into 2021.

DCAP: Mid-Year 2020 Election Changes

- Generally, under the tax laws, once employees make their DCAP election for a calendar year (including an election not to contribute), they cannot change the election during that year except in limited circumstances such as a change in family status (e.g., significant changes in day care costs).
- Under the new IRS guidance, the Employer may permit employees to change—i.e., increase, decrease, or suspend—their DCAP contribution election for 2020 for any reason. These mid-year elections may apply prospectively only. No refunds of DCAP contributions already made in 2020 are permitted.

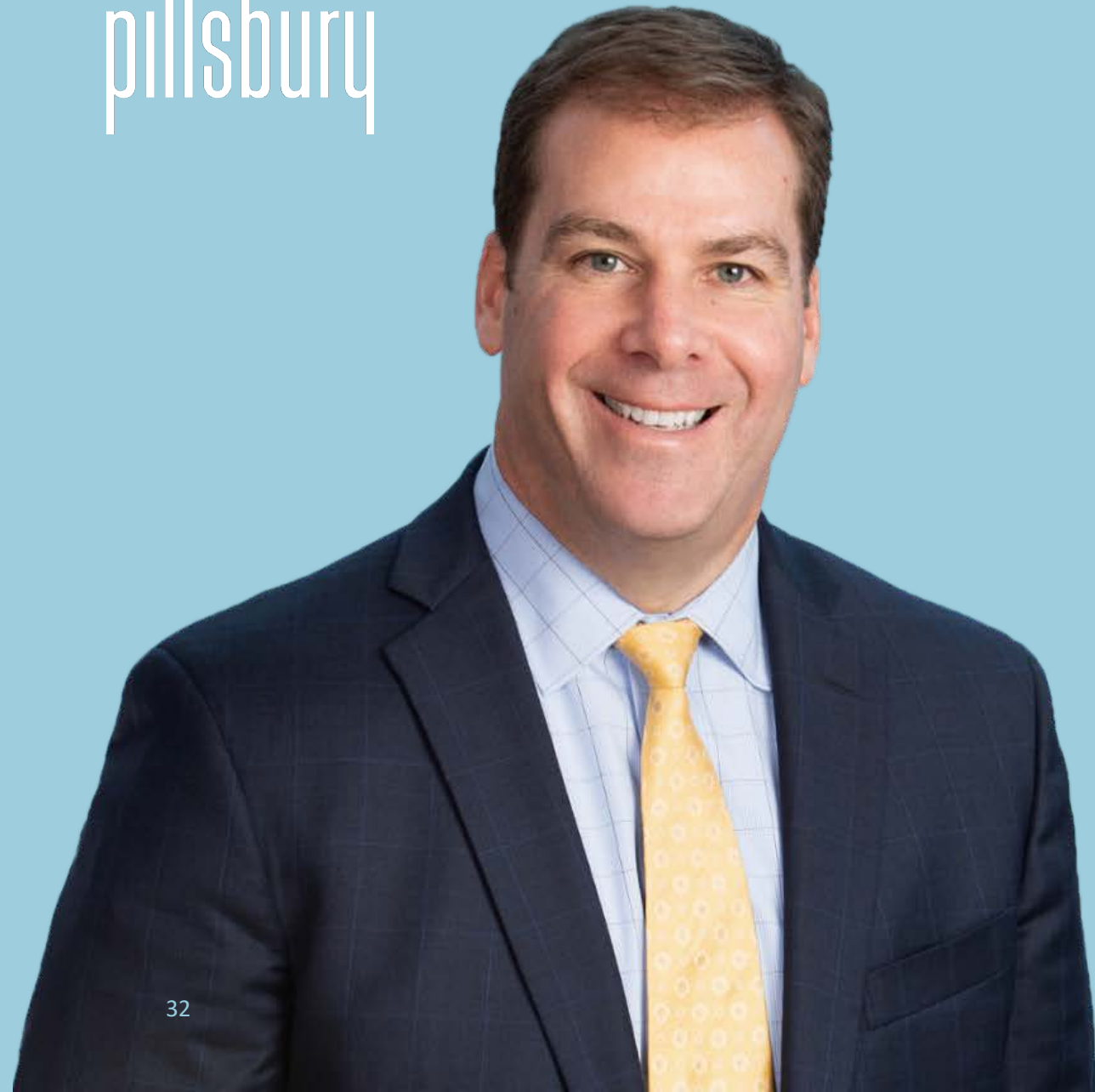
Pre-Tax Medical Premium: Mid-Year 2020 Election Changes

- Generally, under the tax laws, once employees make their health/dental/vision coverage elections for a calendar year (including an election not to receive coverage), they cannot change the election during that year except in limited circumstances such as a change in family status (e.g., divorce, marriage, birth, etc.).
- Under the new IRS guidance, the Employer may permit employees to change—i.e., increase, decrease, or suspend—their coverage election for 2020, as follows:
 - Enroll in coverage. Employee who previously declined coverage may choose to enroll.
 - Switch plans or coverage levels. Enrolled employee may switch plans or elect a new coverage level (e.g., self-only to family).
 - Drop coverage to enroll in other coverage. Enrolled employee may drop health coverage, but only if the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the Employer.

Suggested Next Steps

- Decide whether to add this feature to the Employer's plan. The next steps apply only if you want the feature added.
- If the Employer is interested in permitting employees to increase, decrease, or suspend their health/dental/vision elections, it should first check with coverage provider. (The Employer can unilaterally made the FSA and DCAP changes without notifying any coverage provider.)
- Instruct the plan's third-party administrator (TPA) to implement the new feature.
- Notify employees of the new feature in writing. The TPA should have a sample notice handy.
- Amend the cafeteria plan accordingly by December 31, 2021.

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Tax Credits and Deferrals

Employee Retention Tax Credit

- Refundable payroll tax credit equal to 50% of up to \$10,000 in qualified wages paid by employers during the COVID-19 crisis
 - Applies to wages paid between 3/13/20 and 12/31/20
 - Maximum credit of \$5,000 per employee
- Not available to employers that receive a paycheck protection program loan under the CARES Act
- Available to employers that carry on a trade or business during 2020, including tax-exempt entities, whose:
 - Operations were fully or partially suspended due to a COVID-19 related “shut-down order” during a calendar quarter, or
 - Gross receipts declined during a calendar quarter by more than 50% when compared to the same quarter in the previous year

Employee Retention Tax Credit

- Definition of “qualified wages” depends, in part, on the average number of full-time employees employed on average during 2019, as determined under the Affordable Care Act on a controlled group basis
 - If had more than 100 employees during 2019, “qualified wages” are limited to wages paid to employees when they are not providing services due to shut-down or reduction in gross receipts
 - If had 100 or fewer employees during 2019, “qualified wages” includes all wages paid to any employees (whether open for business or subject to a shut-down) during the shut-down or reduction in gross receipts
- Qualified wages include qualified health plan expenses paid by employer or employee on pre-tax basis
- Qualified wages exclude any amounts for which the employer receives the COVID-19 leave tax credits
- Eligible employer may take credit with respect to pre-tax health plan costs paid for employees, even if not paying other wages during furlough period
 - Allocable health plan costs determined on pro-rata basis among covered employees
 - If greater than 100 employees, costs must relate to periods not working
 - If 100 employees or less, costs may relate to periods working or not working

COVID-19 Sick Leave

- Emergency Paid Sick Leave Act – certain employers must provide employees with **2 weeks of paid sick time** if employee is unable to work (or unable to telework) due to COVID-19 related reasons
 - Generally covers employers with less than 500 employees
 - Potential exemption for employers with less than 50 employees if providing such leave would jeopardize the viability of the business as a going concern
 - Full time employees entitled to 80 hours of paid sick leave; part-time employees entitled to leave equal to number of hours worked on average over 2-week period during past six months
 - Employees taking leave due to quarantine/isolation order, who have been advised by health care provider to self-quarantine, or are experiencing COVID-19 symptoms and seeking medical diagnosis are entitled to **greater of regular pay rate or minimum wage rate, up to \$511 per day, or \$5,110 in aggregate for the two weeks**
 - Employees taking leave to care for another individual due to the reasons set forth above, or for a child whose school or place of care is closed or because they are experiencing another substantially similar illness are entitled to **two-thirds regular pay rate, up to \$200 per day, or \$2,000 in aggregate for the two weeks**
 - Effective 4/1/20 – 12/31/20

COVID-19 Sick Leave

- Emergency Family and Medical Leave Expansion Act - expands FMLA to provide right to take up to 12 weeks of job-protected leave if unable to work because must care for a child whose school or care provider is closed or unavailable due to a COVID-19 emergency declared by a governmental entity
 - Generally covers employers with less than 500 employees; potential exemption as described above
 - First 10 days of leave may be unpaid; subsequent 10 weeks must be paid, can use leave under the Emergency Paid Sick Leave Act during this time
 - **Rate of not less than 2/3 of employee's regular pay rate, up to \$200 per day or \$10,000 in aggregate**
 - Hourly employees – paid leave rate should equal the average number of hours that the employee was scheduled per day over the 6-month period prior to the leave
- Tax Credit – employers eligible for refundable tax credit for amount of COVID-19 leave paid
 - Includes additional two weeks of sick leave and expanded FMLA leave
 - Credit may be increased to include cost of health plan coverage allocable to sick leave

Claiming the Tax Credits

- Same procedure for employee retention credit and COVID-19 sick leave credits
- Process to claim credits
 - Credit allowed against employer portion of Social Security tax
 - Eligible employers may claim credit on Form 941 - quarterly employment tax return
 - May claim credit in advance by reducing federal employment tax deposits
 - To extent employment tax deposits are not sufficient, file Form 7200 with IRS for advance refund

Opportunity to Defer Employment Taxes

- The CARES Act provides that all employers and self-employed individuals may defer payment of the employer share of the Social Security tax owed on wages paid for the period beginning on March 27, 2020 ending on December 31, 2020
- Deferred taxes are due in two installments:
 - 50% by December 31, 2021, and
 - 50% by December 31, 2022
- Payroll tax deferral opportunity available to all employers without regard to size or industry and with no requirement to show any specific COVID-19-related impact
- Paycheck Protection Program Flexibility Act eliminated restriction under the CARES Act which previously required that employers receiving a loan under the Paycheck Protection Program could not continue to defer after the employer receives a decision from the lender that the PPP loan is forgiven

CLE Verification Code

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Q&A Session



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The Pillsbury logo, featuring the word "pillsbury" in a lowercase, sans-serif font. The letters are a dark red color. The logo is positioned on a white rectangular background that is slightly offset to the right and bottom of the page.