Reopening and Rehiring Raise Benefits and Pay Considerations

Pay attention to the vesting and benefit accrual language in plan documents

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As many employers are on the way to normalizing their business practices and re-engaging their employees, they should not overlook the many potential pitfalls in the administration of their retirement, health and welfare plans and their executive compensation arrangements.

The risks of missteps are high, and include loss of tax-qualification of retirement plans, penalty taxes in connection with the Affordable Care Act's (ACA) employer mandate rules, other IRS penalties, employee lawsuits and Department of Labor enforcement actions.

The following summarizes key employee benefits and executive compensation considerations as employers reopen and rehire during the COVID-19 pandemic.

SHRM RESOURCE SPOTLIGHT

Return to Work (www.shrm.org/ResourcesAndTools/Pages/Return-to-Work.aspx)

Eligibility Determinations

When putting employees on furlough, many employers desired to continue benefits for these individuals. Before doing so, employers should have made certain that their coverage of these employees was consistent with the provisions contained in their plan documents.

This is equally true for the reinstatement of these individuals to active employment. *T*his means that the official plan document must provide clear rules on eligibility but so too should ancillary documents such as benefits guides, summary plan descriptions and other employee communications.

Accordingly, the first step in the administration of benefits in reopening is to review these documents and determine if any amendments are needed. Below we discuss how eligibility rules will impact different types of benefit plans.

Qualified Retirement Plans

401(K), 403(B) AND DEFINED BENEFIT PLANS

Generally, an employee on a furlough will be treated as though they are on an unpaid leave. Thus, when returning to work, there will be no break in participation under a qualified retirement plan.

With respect to a terminated employee, if the employee was a participant before their termination they must be eligible to participate on the date of their rehire.

In either case, the plan may have rules relating to service crediting, however, that could limit the service that is credited to employees for periods they are not working. Significantly, there could be a plan rule that might cause a "break in service" to occur in a year in which less than 500 hours of service is credited to a participant.

Among other qualified retirement plan considerations:

- **Automatic enrollment.** Generally, absent plan language to the contrary, an eligible rehired employee will be automatically enrolled at the plan's default deferral percentage if an affirmative election is not made on a timely basis.
- **Loans.** Employers should review their payroll systems to ensure that loan repayments properly continue for employees returning from furlough. Loan payments may have been suspended during the furlough period but these payments should re-commence on return to work. This is especially important because the Coronavirus Aid, Relief, and Economic Security (CARES) Act permits employees to suspend loan repayments until Dec. 31, 2020.

EQUITY INCENTIVE PLANS

Many employers provide their executive employees with equity-based compensation in the form of restricted stock or restricted stock units, stock options, stock appreciation rights and other grants or awards where the employer's stock is either granted or is used to determine the value of the awards. Typically, such grants or awards will have vesting provisions that can be time-based or performance-based, but in most cases will have a provision that calls for the termination or forfeiture of the grant or award at the time the grantee's employment terminates if the award is not vested at that time, and may also provide for termination (particularly in the case of options) at some specified date following termination of employment, even if the award is already vested.

While these type of compensation arrangements are subject to some regulatory schemes, and may (as in the case of incentive stock options) also be subject to varied tax treatment that is linked to the grantee's status as an employee, there is a great deal of latitude in how these types of grants and awards can be handled with respect to furloughed employees.

A critical issue to consider is whether the plan under which these grants or awards are issued has provisions that are relevant specifically to a furlough or temporary leave of absence. Equity compensation plans generally have provisions relating to terminations of employment with different provisions applicable based on the type of termination (e.g., for cause, without cause, death or disability).

The plan may not, however, speak to how furloughs and temporary leaves are treated. It is, therefore, important for employers to review their plans and the award documents to determine if the treatment of these grants and awards is consistent with what would make the most sense, would preserve the purposes of the plan as part of the employer's overall compensation program and promote the employer's best interests in light of the circumstances the COVID-19 pandemic has created.

If the provisions of the plan or award documents would lead to a result that is undesirable, there may be (and typically there are) provisions in the plan that permit amendments to the plan itself or to award agreements that may be helpful and appropriate. Considerations for an employer in this situation would include the following:

- What happens to vesting provisions during a leave of absence, and is a COVID-19 furlough within the scope of such provisions.
- If amendment of the plan is desirable, who must amend, and are there any requirements (such as shareholder approval) that must be met.
- Who has the authority to amend specific award agreements, and could the amendment cause the award to be treated differently for tax purposes – such as triggering concerns under Section 409A of the Internal Revenue Code, or causing an "incentive stock

option" to be treated as a nonqualified stock option.

Health & Welfare Plans

The following are considerations for re-enrolling employees in health and welfare plans.

EMPLOYEES TERMINATED FROM EMPLOYMENT

- **Rehire after less than 13-week absence.** If the employee is rehired within 13 consecutive weeks from their termination of employment, and the employee was participating in the medical plan before their employment was terminated, the ACA mandates that the employee be re-enrolled in the plan on the date of their rehire.
- **Rehire after an absence of 13 weeks or greater.** In this scenario, the employee is treated as a new employee, and their eligibility will be determined by the terms of the plan document. However, note that, if on the date of rehire the employee is reasonably expected to average 30 or more hours per week, the employee must be eligible for the medical plan no later than 90 days following the date of rehire. Some employers may want to disregard any waiting period for returning employees. To do so, they may need to amend their plans.

FURLOUGHED EMPLOYEES

Often, health and welfare eligibility is premised on full-time status. If the employee is a full-time employee on their date of rehire, the employee will likely be eligible to participate in most, if not all, health and welfare plans with no waiting period.

DETERMINATION OF FULL-TIME STATUS

An employer may use either a "monthly measurement method" or a "lookback" method to determine whether an employee is classified as a full-time employee for ACA purposes. If the lookback method is used, this means that the employer measures an employee's hours for a particular period and if the hours justify full-time status, then the employee retains that status throughout a subsequent "stability period" (which most commonly is a plan year).

For this reason, where an employer uses a lookback measurement period to determine eligibility under the medical plan, provided the employee was in a stability period at the time they were furloughed (during which they were considered to be a full-time employee), the ACA stipulates that the employee should have retained their full-time status during the furlough period, even if the employee was not paid during this period. In other words, if the full-time employee was enrolled in coverage on the date they were furloughed, they should have continued to be enrolled in coverage during the furlough period (assuming all applicable premiums were timely paid). Such an employee will continue to be enrolled in coverage following their rehire until at least the end of the current stability period.

If the employer does not use a "lookback" method but instead measures full-time status for plan purposes on a monthly basis, then the employer would have had more flexibility to consider furloughed employees eligible or ineligible for benefits during the furlough period. Upon a return to work, if working a full-time schedule, the returning employee should be offered medical benefits.

PLAN DOCUMENT CONTROLS

Notwithstanding the above-mentioned ACA rules, the plan document determines when an employee is eligible to participate in the plan. Employers should consider amending their health and welfare plans to achieve desired results for rehired employees.

New Rules for Cafeteria Plan Elections

IRS Notice 2020-29 suspended long-standing federal regulations (https://www.littler.com/publication-press/publication/reopening-health-plan-elections-mid-year-irs-leaves-it-employers) that limit when an employee can make mid-year changes to employer-sponsored health coverage. The new rules allow employers to amend their Section 125 plans (known as flexible benefits plans or cafeteria plans) to permit mid-year changes to coverage for the 2020 plan year, regardless of whether the change is permitted under the existing IRS regulations.

ACA Reporting

Many employers will likely incorrectly report the status of furloughed workers on their Forms 1094-C and 1095-C—and the IRS penalties can be significant. Generally, furloughed employees are *not* considered terminated during their furlough. This means that code '2B' (employee was not a full-time employee), and not code '2A' (employee was not employed during the month), should be used on Form 1095-C, line 16, in each month of the furlough during which the employee was not offered healthcare coverage.

However, where the employer uses a lookback measurement period to determine eligibility, and the employee was considered a full-time employee during the furlough period, employers should use the applicable safe harbor code on Form 1095-C, line 16, in each month of the furlough period.

There are many exceptions to the reporting rules stated above. For that reason, employers should consult legal counsel when preparing ACA Forms for 2020.

Service Crediting Issues for Re-Engaged Workers

Employers must pay close attention to the vesting and benefit accrual language in their retirement plan documents as it relates to rehires and those returning from a furlough. For example, if vesting and/or benefits accrue on an elapsed time basis, and the furloughed employee did *not* incur a break in service during the furlough period, then the furlough period will be counted towards vesting for that individual.

With respect to breaks in service, a furloughed or terminated employee may have incurred a break in service under the retirement plan during their absence. For example, many retirement plans state that a participant incurs a break in service if the participant is credited with less than 500 hours of service during the plan year. If the participant incurred a one-year break in service, that may impact the participant's ability to accrue benefits or an additional year of vesting under the plan.

The Impact of New COBRA Rules for Returning Workers

The DOL issued guidance (https://www.littler.com/publication-press/publication/cobra-temporarily-social-distancing-its-election-and-payment-deadlines) that suspends election and payment deadlines through the "outbreak period." This period lasts from March 1 through the 60th day following the expiration of the national emergency declaration.

Claims should not be denied during these periods, but employers are permitted to pay them retroactively when coverage is elected and paid for. Different insurance companies and third-party administrators of health plans construe these rules differently, with some allowing claims to be "pended" (neither approved nor denied) during periods of non-payment.

COBRA notices revised by the DOL after it issued this guidance do not address these suspension issues. Therefore, plan fiduciaries should provide additional notices to COBRA beneficiaries.

Avoiding 409A Penalty Taxes

Under Code Section 409A, there is no separation from service on account of bona fide leave of absence if the period of such leave does not exceed six months, or if longer, so long as the individual retains a right to reemployment with the employer under an applicable statute or by contract.

Furloughs create an odd situation as there is often an intention to re-employ workers but no right to re-employment. Therefore, if an employee is on a furlough that exceeds six months, the 409A rules may require that the employee is considered to be separated from service, which could trigger a plan payout.

Necessary Plan Amendments

In order to meet an employer's business needs, it may be necessary for employers to amend their retirement and health and welfare plan documents. The following are a few examples of when an amendment is necessary:

- If an employer does not want to credit service for purposes of retirement plan vesting or benefit accrual during a period of furlough.
- If an employer wants its group health plans to cover "return-to-work" COVID-19 screenings.
- If an employer wants to amend its cafeteria plan to reflect the aforementioned changes set forth in Notice 2020-29 (note: plan sponsors that adopt any of these new rules must amend their plans to reflect the temporary relief, which is only available during 2020. The amendment must be adopted by Dec. 31, 2021, and may be retroactive to Jan. 1, 2020).
- If an employer wants to reduce employee benefit plan benefits, including 401(k) match benefits. Note that many special considerations apply (https://www.littler.com/publication-press/publication/ten-common-benefits-issues-related-covid-19-pandemic-employee) when considering whether to reduce benefits under a retirement plan, especially if the employer wants to reduce or eliminate an employer matching contribution midyear.

Avoiding employee benefits and executive compensation missteps are crucial for employers that are bringing their employees back to work. There have been many ways in which benefit plan participation has been impacted by the pandemic and employers must exercise care when dealing with these issues.

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Related SHRM Articles:

Returning Employees May Need Accommodations and Support (www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/viewpoint-returning-employees-may-need-accommodations-and-support.aspx), *SHRM Online*, August 2020

Benefits Considerations for Onboarding Furloughed and Laid Off Employees (www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/benefits-consideration-for-onboarding-furloughed-and-laid-off-employees.aspx), *SHRM Online*, July 2020