

## **COVID-19 Considerations for Certain Compensation and Employee Benefit Arrangements**

Written by Ellie Kang, Teresa A. Martland

March 31, 2020

As the economic repercussion of the COVID-19 pandemic is becoming increasingly severe, employers should consider its potential impact on the design and administration of various compensation and employee benefit arrangements.

### **Performance-Based Compensation Programs.**

Due to the economic uncertainty created by the pandemic, employers with a performance-based compensation program (whether in the form of a short-term cash bonus or a long-term equity award) may need to adjust the existing performance targets, introduce new performance metrics, or otherwise design an alternative or additional incentive program. In doing so, employers should consider the following:

- The plan document may contain a broad adjustment provision that could reasonably be interpreted to authorize adjustments to performance targets for COVID-19-related events. Even if no such provision exists, the plan or related award agreements may be amended to provide for the adjustments or, in the case of equity awards, the outstanding award may be replaced by a new award. Employers should consider any accounting and tax implications of any of these actions. Public companies would also need to consider any SEC disclosure requirements and scrutiny from proxy advisory firms, as well as plan prohibitions on direct or indirect repricing in the case of equity awards.
- If the 2020 performance targets have not yet been set, it may be practicable to wait to set the targets until the impact of COVID-19 can be assessed more meaningfully. In addition, for the 2020 performance period (and possibly beyond), employers may wish to use a less formulaic approach and give more weight to qualitative and individual performance metrics (vs. quantitative and company-wide metrics).
- For many employers, equity-based awards may be more appropriate than cash-based incentive programs under the current economic climate. Such employers should consider whether the share reserve under the applicable equity plan needs to be increased (and shareholder approval may be needed for such increase).
- Although the performance-based compensation exception under Section 162(m) of the Internal Revenue Code (the “Code”) that existed prior to the 2017 tax reform is no longer applicable to any new performance-based compensation arrangement, modifying multi-year performance arrangements that were in effect on November 2, 2017 could result in the loss of their grandfathered status.
- Employers seeking financial assistance under Title IV of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) will need to comply with the compensation limits imposed on certain employees whose total compensation in 2019 exceeded a certain dollar threshold. The limits apply to a covered employee’s total compensation, including bonuses and stock awards. Identifying the covered employees, as well as tracking compensation paid to those employees during the applicable limitation period, may be administratively challenging due to the lack of guidance on a number of points.

### **Qualified Retirement Plans.**

The COVID-19 pandemic could potentially raise a number of compliance and operational issues with respect to qualified retirement plans, such as a “401(k)” plan or a defined benefit pension plan.

- Employers may find it difficult to make employer contributions to retirement plans, and failure to make such contributions that are

otherwise not permitted to be suspended or reduced under applicable law could jeopardize plan qualification. The CARES Act provides some relief for single-employer defined benefit plans (see [Client Alert on the CARES Act: Provisions Affecting Retirement and Health Plans](#) for additional details).

- While many 401(k) plans provide for only discretionary matching or profit sharing contributions, an employer that has a practice of making such contributions should notify its employees if it will not be making such contributions for 2020.
- Employers may experience additional burden of administering increased requests from the plan participants for plan loans or hardship distributions.
- The CARES Act includes a number of provisions regarding retirement plans that are intended to provide financial relief for plan participants adversely affected by COVID-19. A discussion of these provisions, which include higher loan limits, extended loan repayment date, suspension of penalty taxes on early distributions, and suspension of required minimum distributions, can be found at [CARES Act: Provisions Affecting Retirement and Health Plans](#).

### Health Benefit Plans.

The COVID-19 pandemic resulted in a number of legislative and regulatory actions affecting employer-sponsored health benefit plans, some of which are listed below. While these actions are sensible efforts to alleviate the financial and administrative burden of testing, treating and preventing COVID-19, they will likely result in an increased cost of providing health benefits for the employers that are sponsoring (or participating in) a health benefit plan.

- The Families First Coronavirus Response Act generally mandates health plans to cover certain COVID-19 diagnostic testing and related items and services without out-of-pocket cost to the plan participants.
- The IRS issued guidance clarifying that a high deductible health plan (a “HDHP”) may provide for COVID-19 testing and treatment regardless of whether the minimum required deductible is satisfied, without jeopardizing its status as a HDHP or disqualifying participants from making contributions to a tax-favored health savings account.
- The CARES Act provides for additional mandates regarding preventive services, telehealth and over-the-counter products, which are discussed in more detail at [CARES Act: Provisions Affecting Retirement and Health Plans](#).

Employers expecting a significant disruption to their workforce due to COVID-19, whether in the form of reduced hours, reduced pay, leaves of absence, layoffs, or otherwise, should consider how any such action could raise operational and design complexities in the context of their health plans. For example, employees with reduced hours may no longer be eligible to participate in the plan and employees with reduced pay may no longer be able to pay the employee-portion of the health coverage premiums. Employers that wish to provide coverage to the affected employees should consult with their legal counsel and the applicable insurance carriers, third-party administrators and other plan-related vendors to ensure that there are no administrative, tax or legal impediments to any contemplated action.

### Nonqualified Deferred Compensation Arrangements.

Employers that maintain a nonqualified deferred compensation arrangement subject to Section 409A of the Code should be mindful of the limited circumstances under which the payment of a deferred amount can be accelerated or delayed. Generally, unless expressly permitted under Section 409A of the Code, changes cannot be made to the timing and form of payment of any deferred compensation. Two provisions may be particularly relevant in the context of the COVID-19 pandemic.

- Accelerated payment is permitted under Section 409A of the Code due to an “unforeseeable emergency,” which generally includes a severe financial hardship to the service provider resulting from an illness of the service provide or of his or her spouse, beneficiary or dependent or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the service provider’s control. However, accelerated payment is not allowed if the emergency may be relieved through payment from insurance or otherwise, by liquidation of the service provider’s assets (to the extent it would not cause severe financial hardship), or by cessation of deferrals under the plan.
- The employer may delay a payment if making the payment would jeopardize the employer’s ability to continue as a going concern. In such case, the payment must be made during the first taxable year of the employer in which the payment would not so jeopardize the employer. The question of whether the employer’s ability to continue as a going concern is jeopardized is a facts and circumstances determination; however, it is intended to cover more than just threatened insolvency and may cover situations where payment without the permitted delay would result in a breach of a loan provision.

The rules concerning a nonqualified deferred compensation arrangement under Section 409A of the Code are complex and the adverse

tax consequences that could result from a failure to comply with these rules are severe. Employers should consult with their legal counsel before taking any action with respect to a nonqualified deferred compensation arrangement.

### Severance Pay Programs.

Employers may be providing severance pay or benefits to former employees terminated as a result of COVID-19, which generally may be provided on a discretionary basis without any written policy or program or pursuant to a formal written plan. A regular practice of providing severance pay or benefits could give rise to a severance pay program that is subject to the Employee Retirement Income Security Act ("ERISA") even if the intent was not to create an ERISA plan. If a severance program is subject to ERISA, it is required to satisfy a number of procedural, reporting and disclosure requirements, including providing eligible employees with summary plan descriptions and, in some cases, filing annual reports on IRS Form 5500. Accordingly, employers considering paying severance to employees terminated as a result of COVID-19 should consider whether such severance practice would be subject to ERISA.

**Foley Hoag has formed a firm-wide, multi-disciplinary [task force](#) dedicated to client matters related to the novel coronavirus (COVID-19). For more guidance on your COVID-19 issues, visit our [Resource Page](#) or contact your Foley Hoag attorney.**

#### RELATED INDUSTRIES

- [Life Sciences](#)
- [Professional Services](#)
- [Technology](#)
- [Energy & Cleantech](#)
- [Education](#)
- [Healthcare](#)

#### RELATED PRACTICES

- [COVID-19 Task Force](#)
- [Business Counseling](#)
- [Taxation](#)
- [Debt Finance](#)
- [Emerging Company and Venture Capital](#)
- [Public Companies](#)

---

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.