COVID-19: COVID-19 CONSIDERATIONS: COMPENSATION TOPICS

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U.S. Benefits, ESOPs, and Executive Compensation Alert

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In the wake of the COVID-19 pandemic and the resulting economic uncertainty, many employers are searching for ways to be financially prepared in the weeks and months to come while simultaneously balancing the well-being of their employees. This article highlights some things employers may wish to keep in mind when making decisions with respect to their employer-sponsored compensation agreements, plans, and arrangements.

A REDUCTION IN FORCE MAY TRIGGER PAYMENT UNDER NONQUALIFIED DEFERRED COMPENSATION ARRANGEMENTS.

Generally, a nonqualified deferred compensation plan is a plan, agreement, or arrangement that allows an employee to earn compensation in one year but defer taxes by receiving payment in a future year. These plans and arrangements are subject to § 409A of the Internal Revenue Code of 1986, as amended (the “Code”), and include traditional salary deferral plans and supplemental executive retirement plans as well as certain cash incentive plans, equity incentive plans, and severance plans (including severance arrangements in executive employment agreements). Most nonqualified deferred compensation plans are intended to be unfunded, meaning that the employer's promise is unsecured and that the benefits provided under the plan will typically be paid when due from the then current general assets of the employer. To comply with Code § 409A, benefits under nonqualified deferred compensation plans are often structured to be paid upon the employee's “separation from service.” Consequently, a reduction in force could trigger payment obligations under an employer's nonqualified deferred compensation plans. Further, reductions in force that could trigger payment under nonqualified deferred compensation plans are not limited to terminations. For example, a furlough that exceeds six months would generally be considered a separation from service under a nonqualified deferred compensation plan.

Once a payment under a nonqualified deferred compensation plan is triggered, subsequent deferral of the payment is not possible. Although the terms of a nonqualified deferred compensation plan may permit an employee to elect to delay or change their form of payment, Code § 409A requires that certain conditions be met to do so. One condition is that the election to delay payment not take effect until at least 12 months after the date on which it was made. Accordingly, where payment under a nonqualified deferred compensation plan is triggered by a specified event (including, as discussed above, a “separation from service”), it is too late to delay payment once the specified event has occurred.

What to Keep in Mind: Employers who are considering a reduction in force should review their nonqualified deferred compensation plans and agreements to determine whether payments may be triggered.

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MID-YEAR ELECTION CHANGE UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS PERMITTED FOR UNFORESEEABLE EMERGENCY.

An employee's election to defer compensation under a nonqualified deferred compensation plan typically must be irrevocable and made no later than December 31 of the prior year. In addition, an employee's distribution election typically cannot be accelerated to an earlier date. However, a narrow exception allows an employee to cancel an existing deferral election and receive an earlier distribution due to an unforeseeable emergency. Under this exception, the deferral election must be cancelled in its entirety and the earlier payment may not exceed the amount necessary to satisfy the unforeseeable emergency plus the amount necessary to pay taxes reasonably anticipated as a result of the earlier payment. An unforeseeable emergency is a severe financial hardship of the participant resulting from an illness or accident of the participant (or the participant's spouse, beneficiary, or dependent) or other similar extraordinary and unforeseeable circumstances arising from events beyond the participant's control, which can be a difficult standard to meet.

What to Keep in Mind: For some participants, the current extraordinary circumstances involving COVID-19 may present a situation that satisfies the unforeseeable emergency standard. Employers should consider whether their nonqualified deferred compensation plans allow participants to cancel their deferral elections mid-year or to receive earlier distribution due to an unforeseeable emergency and may wish to amend their plans to do so if not currently allowed.

STOCK OPTION REPRICINGS

Many companies—public and private—have suffered steep declines in their stock prices in the wake of the COVID-19 pandemic. These steep declines have caused many employee stock options to become “underwater,” thereby causing companies to take accounting charges and deplete equity plan reserves for stock options that no longer incentivize or motivate employees. As in the Great Recession of 2007–2009, companies are encouraged to consider mitigating these undesirable consequences through stock option repricings and exchange programs. (From 2008 through March 2009, almost 100 public companies repriced underwater options, including eBay, Google, Intel, and Starbucks). A stock option repricing or exchange program entails many issues and considerations, including shareholder approval requirements under exchange listing rules, guidelines from institutional investors and proxy advisory firms (including Institutional Shareholder Services), accounting charges under Accounting Standard Certification Topic 718, tender offer rules under the Securities Exchange Act of 1934, as amended, and tax treatment under the Code. Please look out for an alert from us covering these issues in more detail.

EMPLOYERS MAY PROVIDE HOME OFFICE EQUIPMENT TO EMPLOYEES NEEDING TO WORK FROM HOME.

Utilizing the working condition fringe benefit exclusion may allow employers to provide their employees with tools necessary to work from home, including home internet, computer equipment, and other workspace items, without requiring the employee to recognize any income for the receipt of those items. The working condition fringe

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benefit exclusion under Treasury Regulation § 1.132-5 exempts from income property or services provided to an employee to the extent that such payment would be allowable as a deduction under Code § 162 or 167 if the employee had paid for such property or services.

What to Keep in Mind: Employers may be able to provide employees with necessary home office equipment on a tax-free basis.

A SUPPLEMENTAL UNEMPLOYMENT BENEFIT PLAN COULD BE ADOPTED TO COMPENSATE FORMER EMPLOYEES.

A supplemental unemployment compensation plan provides employees who have involuntarily separated from employment with their employer (whether or not such separation is temporary) due to a reduction in force, discontinuance of a plant or operation, or other similar conditions with severance benefit payments that effectively supplement any state unemployment benefits that the employee is otherwise eligible to receive. Such plans are structured to provide a set monthly payment that is offset by the amount of state unemployment benefits the employee is entitled to receive.

What to Keep in Mind: Employers who are considering terminating or laying off employees may wish to implement a supplemental unemployment benefit plan to alleviate some of the financial burden on employees.

EMPLOYEES NO LONGER USING QUALIFIED TRANSPORTATION BENEFITS CAN CHANGE THEIR BENEFIT ELECTIONS MONTHLY.

Through Code § 132, employers often provide qualified transportation benefits, including pre-tax mass transit and parking, to help employees with the expense of commuting to and from employer worksites (up to $270 per month in 2020). These benefits are not subject to the more rigorous election-change rules applicable to cafeteria plan benefits under Code § 125. The period of coverage for these benefits is typically one month. Thus, employees may elect to begin, increase, reduce, or revoke an election each month on a prospective basis.

What to Keep in Mind: Due to COVID-19, employees may no longer need their qualified transportation benefits. Employers may wish to remind employees that they can change their current transportation benefit elections on a prospective basis for any future month and resume their pre-COVID-19 elections when conditions normalize.

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