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Insider

Health and benefit implications of Biden regulatory freeze

By Ann Marie Breheny, Anu Gogna and Ben Lupin

On January 20, 2021, President Biden's chief of staff issued a **regulatory freeze memo** addressing certain regulations issued in the final days of the Trump administration. The memo directs the heads of executive departments and agencies to withdraw regulations that had not yet been submitted to or published in the Federal Register and consider a 60-day delay for regulations that had been published but had not yet taken effect.

The following summary outlines regulations that would be withdrawn, those that may be subject to a delay and additional comment period, and those not impacted by the memo. Employers should monitor additional developments regarding these rules to determine what actions might be required.

The following regulations would be withdrawn immediately:

- **Proposed EEOC wellness regulations on ADA and GINA.** The Equal Employment Opportunity Commission (EEOC) proposed rules on wellness programs under the Americans with Disabilities Act (ADA) and the Genetic Information Nondiscrimination Act (GINA) in response to a decision of the U.S. District Court for the District of Columbia that vacated a portion of the previous EEOC wellness regulations.[1] The ADA wellness regulations detail the incentives employers may offer as a part of wellness programs that ask about employees' health (i.e., make a disability-related inquiry) and/or ask employees to undergo medical examinations, while the GINA wellness regulations detail the incentives that may be offered to an employee whose spouse provides information about the spouse's manifestation of disease or disorder as part of a wellness program. The proposed regulations were not published in the Federal Register as of January 20, so they would be withdrawn.

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- **Proposed HIPAA privacy regulations.** The proposed regulations would make a number of significant changes to the Health Insurance Portability and Accountability Act (HIPAA) privacy rule and are intended to give individuals greater access to their protected health information as well as improve the sharing of an individual's information for care coordination and case management activities.[2] The regulations were published on January 21. They are subject to withdrawal because they were published after the January 20 regulatory freeze memo.

For the following regulations, the regulatory agencies were asked to consider delaying the effective dates for 60 days and open a 30-day comment period:

- **Individual coverage HRAs: ACA employer mandate and 105(h) nondiscrimination final regulations.** Published on January 19, 2021, and effective as of March 15, 2021, these regulations address the interaction of individual coverage health reimbursement arrangements (ICHRAs) and the existing rules under the Affordable Care Act (ACA) employer mandate provisions in Internal Revenue Code section 4980H and the discrimination rules for self-insured group health plans under section 105(h) to allow these code provisions to work with ICHRAs.

[1] See "**EEOC issues proposed amendments to wellness rules**," *Insider*, January 2021.
[2] See "**HHS proposes changes to HIPAA privacy rule**," *Insider*, January 2021.

- **HHS notice of benefit and payment parameters for 2022; updates to state innovation waiver (section 1332 waiver) final regulations.** The ACA established exchanges, often referred to as marketplaces, through which qualified individuals and employers can purchase health insurance coverage in qualified health plans (QHPs). These regulations permit states to transition away from HealthCare.gov — the enrollment website used for QHP enrollment in many states — and facilitate enrolling qualified individuals into individual market QHPs primarily through approved private sector, direct enrollment entities (such as QHP issuers and web brokers). In addition, they include lower exchange user fees for the 2022 benefit year. The rules were published on January 19, 2021, and are effective as of March 15, 2021.
- **Medicare Part D rebate final regulations.** These regulations, which were published on November 30, 2020, with a January 29, 2021 effective date, eliminate the current system of drug rebates in Medicare Part D and would provide prescription drug discounts directly at the point of sale to create incentives to lower list prices and reduce out-of-pocket spending on prescription drugs. A lawsuit challenging these regulations is pending.

Finally, the following recently issued regulations would *not* be subject to a regulatory freeze, because their effective dates occurred before January 20, 2021:

- **Grandfathered plan final regulations.** These regulations provide additional flexibility for group health plans that are exempt from certain ACA requirements (grandfathered group health plans) to make additional changes while retaining their grandfathered status.

[Certain] recently issued regulations would not be subject to a regulatory freeze, because their effective dates occurred before January 20, 2021.

- **Most Favored Nation interim final regulations.** In these regulations, the Centers for Medicare and Medicaid Services announced a new payment model, the Most Favored Nation (MFN) Model, for drugs provided under Part B of Medicare. This rule links the price of prescription drugs under Medicare Part B to the price of the drug in foreign countries.
- **Health care transparency final regulations.** These regulations were issued pursuant to President Trump's executive order on improving price and quality transparency and will directly impact employer-plan sponsors of group health plans by significantly expanding the information that certain group health plans must disclose to participants, beneficiaries and enrollees in health plans.[3] The rule essentially makes health insurance issuers (for fully insured plans) and third-party administrators (for self-insured plans) provide plan participants with an explanation of benefits prior to receiving care to increase transparency in the cost of their health care.
- **COVID-19 vaccine and testing requirements interim final regulations.** These regulations implement the requirement under the Coronavirus Aid, Relief, and Economic Security Act for group health plans to cover qualifying COVID-19 preventive services without cost sharing.[4]

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[3] See "**Q&A: Final rule on health care transparency**," *Insider*, November 2020

[4] See "**Regulations on COVID-19 vaccine and testing requirements issued**," *Insider*, November 2020.

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IRS issues final 162(m) regulations

By Gary Chase and Steve Seelig

The IRS has issued **final regulations** implementing the amendments to Internal Revenue Code section 162(m) made by the 2017 Tax Cuts and Jobs Act (TCJA), with only minor substantive changes to the proposed guidance.[1] Section 162(m) limits the allowable deduction for compensation paid to covered employees of publicly held corporations to $1 million per year. The heavy lifting for corporations will remain in preserving grandfather treatment for certain compensation that will be paid in future years, and to track "covered employees" who may receive compensation in future years (including when a corporation acquires new employees in a merger or acquisition).

The final regulations are generally applicable to tax years beginning on or after December 30, 2020, and taxpayers generally have the option to apply them to tax years beginning after December 31, 2017. However, the final regulations also include special applicability dates for certain provisions that require compliance prior to December 30, 2020.

Because most long-term incentive compensation cycles that were open during 2017 have already paid out, it will be less important for corporations to monitor grandfather treatment, except for unexercised stock options and stock appreciation rights (SARS) that tend to have longer (e.g., 10-year) life spans. Nonqualified deferred compensation (NQDC) – such as excess 401(k), supplemental executive retirement plans and deferred stock units – will also need continued monitoring to support the continuation of grandfathered treatment.

Final regulations

The changes made to 162(m) by the TCJA meant that publicly held corporations have three main tasks in determining whether compensation paid is subject to the $1 million tax-deduction limitation (the $1 million pay cap), which are described below.

1. Determine if the payee is a covered employee.

The TCJA introduced the "once a covered employee, always a covered employee" rule – that is, starting in 2017, an employee who is a covered employee for any year will remain a covered employee for any future year in which compensation is paid by the corporation, even following retirement or death. This is the case even if an employee was a covered employee at certain entities acquired via a merger or acquisition.

[1] See "**Key takeaways from recently proposed 162(m) regulations**," *Insider*, February 2020.

Publicly held corporations have three main tasks in determining whether compensation paid is subject to the $1 million pay cap.

Determining newly covered employees each year: The final regulations continue to define a covered employee as any employee who is the principal executive officer or principal financial officer (or acting as such) of a publicly held corporation at any time during the taxable year. Covered employees also include any executive officer whose total compensation for the company's taxable year places him or her among the three highest compensated officers for the taxable year, determined under the proxy disclosure rules, regardless of whether the corporation's fiscal year and taxable year end on the same date. However, because the employee is not required to be an executive officer at the end of the taxable year, this group may be different from the executive officers disclosed on the proxy. Special rules exist where the company's fiscal year differs from its taxable year.

Tracking covered employees in future years: The final regulations require companies to track their own covered employees into future years when compensation is paid, including years beyond retirement and death. They also include detailed rules on tracking covered employees who were employed at predecessor employers acquired by public corporations, including stock-related transactions, asset purchases involving at least 80% of gross operating assets, certain changes from private to public status and purchases of publicly traded partnerships. Companies must closely monitor acquisitions that take place after the grandfather date, since these events may add to their cadre of covered employees.

Applying the rules to unusual corporate structures: The final regulations retain the guidance on those entities that are considered publicly held corporations for purposes of 162(m) and continue to focus on two possible scenarios:

(1) A corporation's securities are required to be registered under section 12.

(2) A corporation is required to file reports under section 15(d) of the Exchange Act of 1934.

Whether a corporation is considered to be publicly held is determined as of the last day of the corporation's taxable year.

In the final regulations, publicly held corporations continue to include S corporations that issue registered securities or have issued publicly traded debt, wholly owned subsidiary corporations of publicly held corporations that meet (2) above, foreign private issuers that meet (1) or (2) above, a publicly traded partnership that meets (1) or (2) above, and certain affiliated groups and disregarded entities where the parent is private and the subsidiary is publicly traded. Applying these rules can be complicated, particularly when compensation is paid to a covered employee by more than one entity within the affiliated group.

Stand-alone private corporations that become public would be subject fully to the 162(m) deduction limits. A special transition rule exists for corporations that became publicly held on or before December 20, 2019, so they would be exempt from the 162(m) deduction limits. The final regulations clarify that the transition rule also applies to a subsidiary of an affiliated service group that becomes a separate publicly traded organization (e.g., as part of a spin-off transaction). Generally, the transition period ends either on the first shareholder meeting at which directors are elected after the close of the third calendar year following the year in which an initial public offering (IPO) occurs or the first calendar year following the year in which a company becomes public without an IPO.

2. Consider what constitutes compensation paid and whether it is grandfathered.

Generally, 162(m) focuses on the concept of compensation paid, including commissions, whether paid to the covered employee or a beneficiary. The grandfather rule provides that remuneration pursuant to a written binding contract that was in effect on November 2, 2017 (the "grandfather date"), and that was not modified in any material respect on or after such date, can remain deductible when paid – if it would have been deductible under pre-TCJA 162(m) rules. This treatment can apply to compensation that was considered "performance-based" or is NQDC under a written binding contract on the grandfather date.

Counting compensation: The final regulations maintain the rule that compensation paid to a covered employee (by any member of the affiliated service group) is subject to 162(m), regardless of when paid, and companies must count compensation paid to former executives who render services as independent contractors, including those who join the board of directors. Companies also are required to count compensation paid to a covered employee if he or she returns after separation in any capacity, including as a common law employee, a director or an independent contractor.

Additional benefits, contributions or earnings that accrue under a NQDC plan after November 2, 2017, are not grandfathered, with a few exceptions.

Newly public corporations must apply 162(m) to future compensation authorized before they became public, although the grandfather rule might still be helpful for these companies.

Public corporations that own an interest in a partnership would need to count a portion of the compensation paid by the partnership to its covered employees when applying the section 162(m) deduction limitation. However, the final regulations add a special transition rule that only includes these amounts as compensation if paid after December 18, 2020. In addition, the final regulations continue to exclude compensation paid by the partnership after December 30, 2020, if the compensation is paid under a written binding contract that is in effect on December 20, 2019, and that is not materially modified after that date.

Applying the grandfather rule: The final regulations maintain the rule that remuneration is payable under a written binding contract that was in effect on November 2, 2017, but only to the extent that the corporation is obligated under applicable law (for example, state contract law) to pay the remuneration under the contract if the employee performs services or satisfies the applicable vesting conditions.

The final regulations also maintain the rule that negative discretion plans that permit the board to reduce or eliminate promised bonus compensation are not provided under a written binding contract, noting that state law may limit such an amount. Thus, in states with stronger employee wage law protections that would not honor negative discretion, it may be that a larger portion of a promised bonus can be grandfathered regardless of the existence of a negative discretion provision.

A provision that would claw back compensation that should not have been paid, or can be clawed back by exercise of discretion, will continue not to affect the existence of a written binding contract, regardless of whether the amounts actually are clawed back.

The final regulations continue to provide that additional benefits, contributions or earnings that accrue under a NQDC plan after November 2, 2017, are not grandfathered, with a few exceptions:

- If a company does not have discretion to terminate or materially amend the plan, the grandfathered amount would include the benefit as of November 2, 2017, plus any additional benefits, contributions or earnings that accrue after that date.
- If a company has discretion to terminate the plan, then the grandfathered amount includes the lump sum value of the total benefit determined as if the plan was terminated on November 2, 2017 (or, if later, the earliest possible date that termination is permitted under the terms of the plan), plus any additional benefits, contributions or earnings that the company is required to make through the earliest date that the benefit may be distributed to the employee. A similar rule applies where a company has discretion to freeze (but not terminate) a NQDC plan, although these plan provisions are rare.

The final regulations add an alternative grandfather rule that would simply permit corporations to ignore earnings, losses and new contributions from being considered as grandfathered to help companies reduce their administrative burden of performing potentially detailed calculations.

Because severance amounts often are tied to salary and bonus levels in place at termination, the final regulations maintain that severance is grandfathered only if the severance amount and the underlying salary and/or bonus on which it is based are under a binding written contract in effect as of November 2, 2017. In that circumstance, the grandfathered amount would be based only on the salary and bonus in place on the grandfather date; future increases would not be grandfathered unless those were guaranteed by contract. However, severance may be grandfathered if based on salary increases that are hard coded into the agreement or reasonable cost-of-living adjustments but would not be grandfathered if based on discretionary bonuses whose value is determined after the grandfather date.

The final regulations maintain the ordering rule for NQDC that is distributed over a period of years where only a portion of the compensation is grandfathered. In that case, the grandfathered amount is allocated to the first otherwise deductible payment paid under the arrangement. If the grandfathered amount exceeds this payment, then the excess is allocated to the next otherwise deductible payment paid under the arrangement. This process is repeated until the entire grandfathered amount has been paid.

3. Determine if there has been a material modification for grandfathered amounts.

Any action that changes the value of a grandfathered amount must be closely monitored to ensure there are no material modifications that could cause the entire amount to lose grandfather status.

Under the final regulations, the following may be treated as a material modification:

- A contract that is amended to increase the amount of compensation payable to the employee.
- A supplemental contract or agreement that provides for increased or additional compensation if, under the facts and circumstances, the additional compensation is paid based on substantially the same elements or conditions as the compensation under the written binding contract. An exception is if the supplemental payment is equal to or less than a reasonable cost-of-living increase over the payment made in the preceding year under that written binding contract. As noted above, the failure, in whole or in part, to exercise negative discretion under a contract does not result in the material modification of that contract.
- An acceleration of future payments of compensation unless the amount of compensation paid is discounted to reasonably reflect the time value of money. An exception to the restriction on accelerating payments is for compensation that was subject to a substantial risk of forfeiture as of November 2, 2017. Under this exception, a company could accelerate vesting of restricted property, a stock option or SAR, or the right to vest in cash, and it is not considered a material modification.
- A deferral of compensation unless the amounts paid in excess of the original compensation are based on either a reasonable rate of interest or a predetermined actual investment (real or notional); however, the interest itself will not be grandfathered. The final regulations include an exception to this deferral rule for stock options or SARs whose exercise periods are extended, which sometimes happens when an employer wants a terminating employee whose options/SARs would have expired to have additional time to exercise those rights.

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HHS announces 2021 federal poverty guidelines

By Maureen Gammon and Anu Gogna

The Department of Health and Human Services (HHS) recently announced the **2021 federal poverty guidelines** — also referred to as federal poverty levels or lines (FPLs). Employers that use the FPL affordability safe harbor to comply with the Affordable Care Act (ACA) employer shared responsibility mandate should start applying the 2021 guidelines when appropriate. (Employers may use the FPL guidelines in effect six months before the first day of the plan year.)

These guidelines are published annually and used by several federal agencies in determining eligibility for federal assistance programs, including Medicare, Medicaid, the Children's Health Insurance Program and the ACA.

Under the ACA, the FPLs are used to determine eligibility for premium tax credits or cost-sharing reduction subsidies and to calculate the employee's required contribution threshold under the FPL affordability safe harbor for the employer shared responsibility mandate.

Background

An employer with 50 or more full-time employees, including full-time employee equivalents — i.e., an applicable large employer, or ALE — must offer minimum essential health coverage that is affordable and provides minimum value to full-time employees and their eligible dependents.

To meet the affordability requirement, the employee contribution for the lowest-cost health benefit option must not exceed 9.83% (for 2021) of the employee's household income. Rather than requiring employers to calculate each full-time employee's household income for the year, the IRS allows the use of three affordability safe harbors: Form W-2, rate of pay and FPL.

Employers may use the FPL guidelines in effect six months before the first day of the plan year.

FPL affordability safe harbor

For purposes of the FPL affordability safe harbor, the FPL is determined by the state in which the employee is employed. The 2021 FPLs for the continental U.S. (48 contiguous states and the District of Columbia), Alaska and Hawaii are as follows:

- Continental U.S.: $12,880 (up from $12,760 in 2020)
- Alaska: $16,090 (up from $15,950 in 2020)
- Hawaii: $14,820 (up from $14,680 in 2020)

For 2021, the FPL safe harbor is determined by multiplying 9.83% by the applicable FPL threshold and dividing that product by 12. The result is the monthly limit on the employee-only required contribution for the ALE's lowest-cost health coverage option that meets minimum value.

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Puerto Rico 2021 retirement plan limits

By Stephen Douglas, Bill Kalten and Lourdes Martinez

The Puerto Rico Treasury Department recently issued **Circular Letter 21-01** (Spanish version) announcing the 2021 benefit limits for defined benefit (DB) and defined contribution (DC) retirement plans qualified under the Puerto Rico tax code. These limits restrict contributions made to and benefits paid from these plans, as well as the amount of compensation that can be taken into account for qualified retirement plan purposes.

Puerto Rico qualified plan limits	2020	2021
Maximum recognizable compensation	**$285,000**	**$290,000**
Highly compensated employee (HCE)[1]	**$130,000**	**$130,000**
Annual benefit limit (DB)	**$230,000**	**$230,000**
Annual contribution limit (DC)	**$57,000**	**$58,000**
Limit on pre-tax elective deferrals		
Qualified only in Puerto Rico		
– Contribution limit	**$15,000**	**$15,000**
– Catch-up contribution limit (age 50 or older)	**$1,500**	**$1,500**
Dual qualified in Puerto Rico and U.S.		
– Contribution limit	**$19,500**	**$19,500**
– Catch-up contribution limit (age 50 or older)	**$1,500**	**$1,500**

Limit on after-tax contributions: 10% of the participant's maximum recognizable compensation for all the years of participation in the retirement plan

The qualified retirement plan limits are effective for the taxable year beginning on or after January 1, 2021.

Going forward

Sponsors of dual-qualified plans and plans qualified solely in Puerto Rico should update their administrative processes and systems to reflect the 2021 limits. These sponsors should also review their administrative procedures to ensure the limits are being monitored.

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[1] Early in 2017, the Puerto Rico Internal Revenue Code was amended to implement a fixed $150,000 compensation threshold for HCEs, rather than linking the threshold to a cost-of-living-adjustment (COLA) dollar amount (as in the U.S. Internal Revenue Code). In December 2018, however, Puerto Rico amended the tax code to, among other things, reinstate the COLA threshold. Note, however, that the change adopted in 2017 that excluded "officers" from the definition of HCE remains in effect.

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