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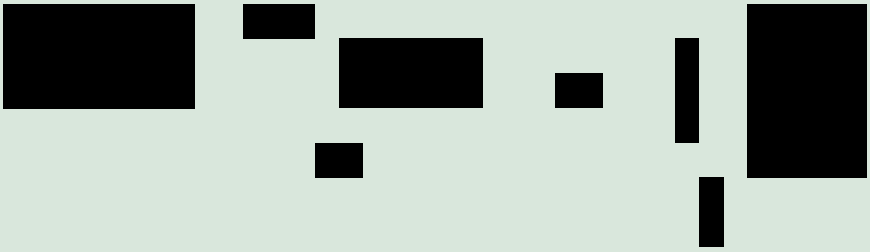

Insider

Key benefit-related proposals included in Trump's 2021 budget

By Precious Abraham, Ann Marie Breheny and Bill Kalten

The Trump administration's proposed budget for fiscal year 2021[1] was submitted to Congress on February 10. The submission outlines the administration's budget priorities for fiscal year 2021 and recommends desired policy changes. Policies proposed in the fiscal year 2021 budget have implications for employer-sponsored retirement and health plans. In addition, the budget proposes a paid parental leave program. Many of these proposals were included in prior budget submissions but have not moved through Congress.

The key benefit-related provisions are discussed below.

General discussion and observations

Retirement

The budget proposes modifications to single employer premiums and new premiums for multiemployer plans.

- **Single employer plans:** The budget would suspend indexing of the premium rates for three years (2021, 2022 and 2023); indexing would resume in 2024. The budget would also increase the variable-rate premium (VRP) cap to $900 in 2021 (up from $561 in 2020) "in order to help restore the incentive to better fund promised pensions."
- **Multiemployer plans:** Underfunded multiemployer plans would pay a VRP, subject to a cap. Employers that exit a multiemployer plan would pay an exit premium equal to 10 times the VRP cap. The budget submission also notes the need for multiemployer pension plan reform and states that the administration is ready to work with Congress on multiemployer legislation.

These changes were also proposed in the fiscal year 2020 budget without gaining legislative traction. Significant retirement legislation – including the Setting Every Community Up for Retirement Enhancement Act (or SECURE Act) – was enacted in late 2019, so lawmakers might not focus on retirement legislation in 2020. However, continued concerns about the financial status of multiemployer pension plans could provide a vehicle for addressing PBGC premiums and retirement provisions.

Health care

The budget includes the following health care-related proposals:

- An allowance would be given for President Trump's health care reform proposals for the stated purposes of improving price and quality transparency, reducing prescription drug costs, ending surprise medical bills and addressing other issues. In a departure from prior years, the budget proposal does not specifically provide for repealing and replacing the Affordable Care Act. A separate allowance would be given for bipartisan drug pricing legislation.
- The budget expresses the administration's support for a Medicare Part D out-of-pocket limit and proposes to lower drug costs for patients at the "pharmacy counter."
- Medicare beneficiaries would be allowed to opt out of Medicare Part A. Medicare beneficiaries with high-deductible health plans could contribute to health savings accounts.
- The Employee Benefit Security Administration would receive funding to develop policies, rules and enforcement capacity to enable more employers to adopt "the

In This Issue

[1] Fiscal year 2021 begins on October 1, 2020. Budget proposals must be enacted through legislation or implemented through regulation before they can take effect.

Multiple Employer Welfare Arrangement model," where smaller employers pool together to share plan costs and administrative burdens.

Paid leave

The budget again proposes six weeks of paid leave for new parents, beginning in 2023. Each state would design its own program, and the benefit would be provided and administered through its unemployment insurance program.

Going forward

Congress will hold hearings to discuss the proposed budget but is not expected to approve the budget's retirement, health or paid leave proposals.

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HHS announces 2020 federal poverty guidelines

By Maureen Gammon and Anu Gogna

The Department of Health and Human Services (HHS) recently announced the **2020 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 2020 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 and the Children's Health Insurance Program.

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 9.78% (for 2020) 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.

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 2020 FPLs for the continental U.S. (48 contiguous states and the District of Columbia), Alaska and Hawaii are as follows:

- Continental U.S.: $12,760 (up from $12,490 in 2019)
- Alaska: $15,950 (up from $15,600 in 2019)
- Hawaii: $14,680 (up from $14,380 in 2019)

For 2020, the FPL safe harbor is determined by multiplying 9.78% 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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Key takeaways from recently proposed 162(m) regulations

By Gary Chase, Bill Kalten and Steve Seelig

The IRS recently issued **proposed regulations** on the amendments made to section 162(m) of the Internal Revenue Code under the Tax Cuts and Jobs Act of 2017 (TCJA), supplementing its prior guidance in **Notice 2018-68**. Section 162(m) limits the allowable deduction for compensation paid to covered employees of publicly held corporations to $1 million per year. The proposed regulations address how the grandfather rules apply to compensation under a written binding contract in effect on the law's November 2, 2017 effective date (the grandfather date)[1] and whether those plans can be amended without harm. Corporations will still need to monitor equity granted before that date as they vest — and options/stock appreciation rights (SARS) that are exercised — to determine if they are grandfathered.

In particular, the proposed regulations provide significant new guidance on how companies must keep track of the "once a covered employee, always a covered employee" rule introduced by the TCJA, particularly for corporations with mergers/acquisitions/spinoffs, and how 162(m) applies to unusual business structures. Finally, the proposed rules clarify that determination of covered employee status for the three most highly paid executive officers is not a year-end exercise: Anyone who reaches that status during the year would be considered.

Fundamental concepts

The proposed regulations provide guidance on each of the following three steps publicly held corporations must take to determine whether compensation paid is subject to the $1 million tax-deduction limitation.

Section 162(m) limits the allowable deduction for compensation paid to covered employees of publicly held corporations to $1 million per year.

1. Determine if the payee is a covered employee

Determining newly covered employees each year. The proposed regulations maintain the definition of covered employee provided in Notice 2018-68, which applies for taxable years ending on or after September 10, 2018. Covered employees include any employee who is, or acts as, the principal executive officer or principal financial officer 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.

Note that the proposed rule for identifying the three highest compensated officers for purposes of 162(m) differs from the proxy disclosure rule, which requires that the employee be an executive officer at the end of the taxable year. Thus, this group may be different from that disclosed on the proxy.

Finally, the proposed regulations provide special rules where the company's fiscal year differs from its taxable year.

Tracking covered employees in future years. Not only must companies track their own covered employees into future years, including years beyond retirement and death, they also must track covered employees who were employed at

[1] The grandfather rule provides that remuneration pursuant to a written binding contract that is in effect on November 2, 2017, and is not modified in any material way on or after such date, is deductible when paid — if it would have been deductible under pre-TCJA 162(m) rules. This can apply to "performance-based" compensation or nonqualified deferred compensation (NQDC) under a written binding contract on the grandfather date.

predecessor employers acquired by public corporations. Companies should now take another look to determine whether their number of covered employees increased due to acquisitions that took place after the grandfather date.

Determining applicability to unusual corporate structures. The proposed regulations provide guidance on which entities are considered publicly held corporations for purposes of 162(m), focusing on whether (1) a corporation's securities are required to be registered under section 12 of the Exchange Act of 1934, or (2) a corporation is required to file reports under section 15(d) of the act. Such status is determined as of the last day of a corporation's taxable year.

Under the proposed regulations, the following are considered publicly held corporations:

- S corporations that issue registered securities or have issued publicly traded debt
- Wholly owned subsidiary corporations of publicly held corporations that meet (1) or (2) above (so subsidiaries will have their own set of covered employees)
- Foreign private issuers that meet (1) or (2) above
- Publicly traded partnerships that meet (1) or (2) above
- Certain affiliated groups and disregarded entities where the parent is private and the subsidiary is publicly traded

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

Counting compensation. Companies 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.

The proposed regulations eliminate the regulatory exception that allowed newly public corporations to avoid applying 162(m) to future compensation if those payments were authorized before they became public. In addition, public corporations that own partnerships would need to count compensation paid to covered employees who are also partners in those entities.

Grandfather rule. Under the proposed regulations, remuneration is payable under a written binding contract that was in effect on November 2, 2017, only when the corporation is legally obligated to pay the remuneration under the contract if the employee performs services or satisfies the applicable vesting conditions.

Companies are required to count compensation paid to a covered employee if he or she returns after separation in any capacity.

The proposed regulations exclude from the grandfather rule compensation that is subject to reduction or recovery by the company. Under Notice 2018-68, negative discretion plans that permitted the board to reduce or eliminate promised bonus compensation are not considered to be provided under a written binding contract. The proposed regulations adopt this rule, noting that state law may limit the amount of compensation that can be reduced using negative discretion. The existence of a provision that claws back compensation that should not have vested, or that can be clawed back by exercise of discretion, does not affect the existence of a written binding contract, except for amounts that actually become subject to clawback.

Under the proposed regulations, both credits and earnings or interest accruing under a non-qualified deferred compensation plan (NQDC) after November 2, 2017, are not grandfathered when the corporation retains the right under applicable law to amend the plan at any time either to stop or to reduce future credits (including earnings). One exception to this rule is for plans that are required by the tax code and plan document to guarantee earnings or interest from the date of plan termination until distribution. We expect more guidance from the IRS addressing several interpretational questions related to NQDC.

Because severance amounts often are tied to salary and bonus levels in place at termination, the proposed regulations clarify that severance is grandfathered only if the amount and the underlying salary and bonus upon which it is based are under a binding written contract in effect as of November 2, 2017. The grandfathered amount would be based only upon the salary and bonus in place on the grandfather date; future increases would not be grandfathered unless guaranteed by contract.

For NQDC that is distributed over a period of years where only a portion of the compensation is grandfathered, the grandfathered amount is allocated to the first otherwise deductible payment. If the grandfathered amount exceeds the payment, then the excess is allocated to the next otherwise deductible payment, repeated until the entire grandfathered amount has been paid.

3. Determine if there has been a material modification

Under the proposed regulations, a material modification is one that amends a contract to increase the employee's compensation. If that happens, the contract loses its grandfathered status, and any future payments are treated as a new contract entered into when modified, subject to the TCJA revisions to 162(m).

Corporations must monitor whether any action they take would change the value of any grandfathered amount. A supplemental contract or agreement that provides for increased or additional compensation is a material modification if the additional compensation is paid on substantially the same basis 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.

Accelerating future payments of compensation would be considered material modifications unless the amount of compensation paid is discounted to reasonably reflect the time value of money. Similarly, deferrals of compensation would be considered material modifications 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.

Under the proposed regulations, a material modification is one that amends a contract to increase the employee's compensation.

An exception to the acceleration prohibition is for compensation that was subject to a substantial risk of forfeiture as of November 2, 2017 (e.g., a company could accelerate vesting of restricted property, a stock option or SAR, or the right to vest in cash, without it being considered a material modification).

Finally, the failure to exercise negative discretion to reduce compensation under a contract does not result in the material modification of that contract.

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Companies will provide feedback to proxy advice, if allowed by SEC

By Steve Seelig

The majority of U.S. publicly traded companies will respond to proxy advisor voting recommendations if given the opportunity by the Securities and Exchange Commission (SEC), according to a Willis Towers Watson poll conducted in December 2019 of compensation and HR professionals at 105 publicly traded U.S. companies.

In November 2019, the SEC proposed amendments to its proxy solicitation rules to improve the accuracy and transparency of proxy voting advice. The proposed rule changes would require proxy advisors to disclose any potential conflicts of interest to clients, allow companies to provide feedback on proxy advice (including factual errors) before it is disseminated to institutional shareholders and permit companies to attach their own hyperlinked statement to the proxy advisors' recommendations.

A large majority of companies (83%) believe the regulations, if finalized, would cause proxy advisors to be more transparent.

A large majority of companies (83%) believe the regulations, if finalized, would cause proxy advisors to be more transparent, and 40% would share hyperlinked statements to proxy advisor recommendations with their institutional investors to further communicate their executive pay philosophy. More specifically, 81% would speak up if they found a factual error: Six in 10 companies (59%) consider factual errors to be a big problem. Additionally, if companies disagreed with proxy advisor testing methodology, or if they received "against" voting recommendations, nearly half (46% and 47%, respectively) said they would provide feedback.

The poll also revealed that companies and their compensation committees will be placing greater emphasis on people issues over the next few years. This comes following a recent SEC proposal to expand Form 10-K disclosure of human capital measures to enhance shareholder understanding of their importance. More than nine in 10 respondents (92%) say managing human capital resources will be important to their success over the next three years, compared with 71% over the past three years. Additionally, nearly three in four respondents (72%) believe their compensation committees will oversee fair pay and gender pay issues in the next three years, compared with 52% that do so currently. More than half (54%) also say their compensation committees will be responsible for inclusion and diversity issues in the next three years, up from 45% currently.

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About Willis Towers Watson

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