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Insider

New EEOC guidance on employer COVID-19 vaccine policies, incentives

By Anu Gogna and Ben Lupin

The U.S. Equal Employment Opportunity Commission (EEOC) has updated its **technical assistance guidance** on the COVID-19 pandemic, answering questions on how federal equal employment opportunity (EEO) laws apply to employer vaccine programs, incentives and other issues related to employees returning to the workplace.

Key updates to the EEOC guidance

- Employers may require COVID-19 vaccines of their employees as long as they provide reasonable accommodations as required under the Americans with Disabilities Act (ADA) and Title VII of the Civil Rights Act of 1964.
- Employers who are administering COVID-19 vaccinations to their employees (either at the workplace or through a contracted vendor) may provide incentives to employees, but those incentives should not be so substantial as to be "coercive."
- Employers may offer incentives to employees for voluntarily providing documentation of COVID-19 vaccination, but the collection of such information is subject to the ADA's confidentiality requirements.

Mandatory vaccination programs

An employer may require all employees physically entering the workplace to be vaccinated for COVID-19, so long as the employer complies with the reasonable accommodation provisions of the ADA, Title VII and other EEO considerations.

However, if an employee cannot obtain the vaccine because of a disability, the employer must assess whether the individual would pose a "direct threat" to his or her own health or safety or that of others in the workplace. If so, the employer must provide a reasonable accommodation, absent undue hardship, to reduce or eliminate that threat, including requiring the employee to wear a mask or work a staggered shift, making changes in the work environment (such as improving ventilation systems or limiting contact with other employees and non-employees), permitting telework if feasible or reassigning the employee to a vacant position in a different workspace.

Similarly, if an employee's sincerely held religious belief, practice or observance prevents him or her from getting a COVID-19 vaccine or the employee objects to taking the vaccine due to pregnancy, then the employer must provide a reasonable accommodation unless it would pose an undue hardship.

Please note that while mandatory vaccinations do not violate federal EEO laws, an employer must also consider any applicable state and local laws that might be inconsistent with or more restrictive than the EEOC guidance.

Finally, the EEOC recommends as a "best practice" that an employer introducing a mandatory COVID-19 vaccination policy *notify all employees* that requests for reasonable accommodation based on disability, religious objection or

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pregnancy will be considered, on an individualized basis. Employees are responsible for notifying their employer of the need for an exemption. The EEOC also recommends that employers inform managers of how to recognize a request for an accommodation and to whom they should refer such a request.

Employer incentives for voluntary COVID-19 vaccinations and the ADA

Employers may offer incentives to employees to voluntarily provide proof of vaccination obtained in the community, such as a pharmacy, personal health care provider or public clinic. Vaccination information must be kept confidential pursuant to the ADA.

Employers that are administering vaccines to their employees (either at the workplace or through a contracted vendor) may offer incentives for employees to be vaccinated, as long as the incentives are *not so substantial as to be coercive*. Because vaccinations require employees to answer pre-vaccination disability-related screening questions, the EEOC is concerned that a very large incentive could make employees feel pressured to disclose protected medical information. The guidance did not explain what is meant by "so substantial as to be coercive," so any incentive amount should be discussed with legal counsel.

Employer incentives for voluntary COVID-19 vaccinations and GINA

Under the Genetic Information Nondiscrimination Act (GINA), an employer may incentivize employees to provide proof that they or their family members have been vaccinated through a third party, such as a pharmacy or health department.

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Employers...may offer incentives for employees to be vaccinated, as long as the incentives are not so substantial as to be coercive.

However, an employer or contracted vendor providing a vaccination to a family member may not offer an employee an incentive in exchange. This protects against the employer receiving genetic information in the form of the employee's family medical history, which would be collected from the family member when answering pre-vaccination medical screening questions.

Employers may not require employees to have their family members get vaccinated nor penalize them if their family members decide not to get vaccinated. Employers must also ensure that all medical information obtained from family members during screening is only used for the purpose of providing the vaccination; kept confidential; and not provided to any managers, supervisors or others who make employment decisions.

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U.S. Supreme Court upholds Affordable Care Act

By Anu Gogna and Ben Lupin

On June 17, the U.S. Supreme Court voted 7 – 2 to uphold the Affordable Care Act (ACA) in the case of *California v. Texas*. In its **decision**, the court held that the plaintiffs had not shown the sort of direct injury that gave them standing to challenge the ACA's individual mandate requiring most Americans to obtain health insurance or pay a penalty. The court chose not to rule on whether the individual mandate itself was constitutional.

As background, the case started shortly after attempts by Congress to repeal and replace the ACA failed and Congress enacted 2017 tax reforms that cut the individual mandate penalty to $0 starting in 2019. Texas and other states along with two private citizens sued, arguing the individual mandate

is unconstitutional if it no longer imposes any tax. They further argued that because the individual mandate is integral to the ACA, if that provision is unconstitutional then the entire law must fall (due to the ACA not having a severability clause). Oral arguments in the case were held on November 10, 2020, when a majority of the court appeared to be resistant to striking down the entire ACA.

In light of this decision, employers should continue to comply with all applicable ACA requirements, such as covering dependents to age 26, not placing dollar limits on essential health benefits, providing health insurance coverage to avoid the employer mandate and completing ACA information reporting.

In light of this decision, employers should continue to comply with all applicable ACA requirements.

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PCORI fee due by August 2, 2021

By Anu Gogna and Ben Lupin

Under the Affordable Care Act, issuers of specified health insurance policies and self-insured health plan sponsors are required to pay a fee to help fund the Patient-Centered Outcomes Research Institute (PCORI). The fee is based on the average number of covered lives under the policy or plan and must be reported once a year on the second quarter IRS Form 720 and paid annually by July 31 (or the following business day if July 31 falls on a Saturday, Sunday or legal holiday).

The IRS announced in **Notice 2020-84** that the PCORI fee amount for plan years ending on or after October 1, 2020, and before October 1, 2021 is $2.66 per covered life (up from $2.54 previously).

The following is a brief Q&A on the general requirements for filing the PCORI fee.

Q. When did the PCORI fee go into effect and when does it end?

A. The PCORI fee initially applied to specified health insurance policies and applicable self-insured health plans with policy or plan years ending after September 30, 2012, and before October 1, 2019; however, in December 2019 the fee was extended for an additional 10 years under the Further Consolidated Appropriations Act, 2020 and now applies through plan years ending before October 1, 2029.

Q. What types of plans are subject to the PCORI fee and how much is the PCORI fee?

A. The IRS has provided a chart on which **types of insurance coverage or arrangements** are subject to the PCORI fee as well as **filing due dates and applicable rates**, which depend on the month on which a specified health insurance policy or applicable self-insured health plan ends.

The fee is based on the average number of covered lives under the policy or plan.

Q. Who pays the PCORI fee?

A. For fully insured plans, the insurance carrier is responsible for filing **Form 720** and paying the PCORI fee; therefore, employers with only fully insured health plans have no filing requirement (but will be charged by the carrier for the cost of the fee). If an employer sponsors a self-insured health plan, the employer must file Form 720 and pay the PCORI fee. For self-insured plans with multiple employers, the named plan sponsor is generally required to file Form 720.

Q. How do you determine the average number of covered lives under the policy or plan to calculate the PCORI fee for the year?

A. The PCORI regulations require issuers of *fully insured plans* to use one of four alternative methods – (1) the actual count method, (2) the snapshot method, (3) the member months method, or (4) the state form method – to determine the average number of covered lives under a specified health insurance policy for a policy year.

Sponsors of *self-insured plans* must use one of three alternative methods: (1) the actual count method, (2) the snapshot method, or (3) the Form 5500 method.

The method used can be changed from year to year.

Q. Do COBRA-qualified beneficiaries and retirees or other former employees count as "covered lives" for the purpose of calculating the PCORI fee?

A. These covered individuals and their beneficiaries must be taken into account in calculating the average number of covered lives.

Q. Can the PCORI fee be paid from plan assets? Is the PCORI fee deductible?

A. The U.S. Department of Labor has stated that the PCORI fee *cannot* be paid from plan assets. In other words, the PCORI fee must be paid out of the general assets of the employer plan sponsor. It is not a permissible expense of a self-insured plan and cannot be paid in whole or in part by participant contributions. Furthermore, the PCORI fee expense should not be included in the plan's cost when computing the plan's COBRA premium; however, the IRS has **indicated** the fee is a tax-deductible business expense for employers with self-insured plans.

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IRS issues guidance on ARPA COBRA premium assistance

By Maureen Gammon, Ben Lupin and Kathleen Rosenow

The IRS has issued **Notice 2021-31** on the premium assistance available for COBRA continuation coverage under the American Rescue Plan Act of 2021 (ARPA). The Q&A guidance is intended to help employers and their COBRA vendors/third-party administrators determine who is an assistance eligible individual (AEI), calculate the premiums for tax credit purposes and claim such credits.

ARPA includes 100% COBRA premium assistance for up to six months (from April 1, 2021, until September 30, 2021) for individuals who are eligible for COBRA due to an involuntary termination of employment or reduction in hours and are either (1) currently enrolled in COBRA, or (2) in their COBRA continuation period but have not elected or discontinued payments for COBRA coverage.[1]

Due to the COVID-19 pandemic, the departments of Labor and Treasury previously provided relief to employer-sponsored group health plans (GHPs) and their participants from having to comply with certain deadlines, including those for making COBRA elections and premium payments and providing COBRA election notices. The relief, known as the Outbreak Period rules, provide that individuals and plans may disregard applicable deadlines until the earlier of (1) one year from the date they were first eligible for relief, or (2) 60 days after the announced end of the National Emergency (i.e., the end of the Outbreak Period). A disregarded period cannot exceed one year.[2]

ARPA includes 100% COBRA premium assistance for up to six months (from April 1, 2021, until September 30, 2021) for [assistance eligible individuals].

The Q&As in the IRS notice and the implications to employers are described below.

Employer implications

Eligibility for COBRA premium assistance

To determine whether an individual may be eligible for premium assistance, an employer may require the individual to self-certify eligibility (including whether the individual has "other" disqualifying coverage) and rely on that self-certification when providing COBRA continuation coverage with the premium assistance and claiming the COBRA premium assistance tax credit. If employers do not require self-certification of eligibility, they must maintain other documentation to show eligibility for the premium assistance. Tracking "other" disqualifying coverage by an employer will be a challenge.

- An AEI is any individual who is:
  - A qualified beneficiary as the result of (1) the reduction of hours of a covered employee's employment, or (2) the involuntary termination of a covered employee's

[1] See "**Health and benefit implications of ARPA**," *Insider*, March 2021
[2] See "**DOL guidance on end of COVID-19 'Outbreak Period**," *Insider*, March 2021

employment (other than by reason of an employee's gross misconduct)
  - Eligible for COBRA continuation coverage for some or all of the period beginning on April 1, 2021, through September 30, 2021
  - Elects the COBRA continuation coverage
- An AEI includes the employee who had the reduction in hours or involuntary termination of employment resulting in a loss of coverage, as well as the employee's covered spouse and dependent children who are qualified beneficiaries as a result of the same event.
- An individual can become an AEI more than once during the premium assistance period.
- An individual who is eligible for other GHP coverage or Medicare is not an AEI.
- Individuals currently enrolled in individual health insurance coverage through a health insurance exchange may be eligible to elect COBRA continuation coverage and receive COBRA premium assistance; however, they cannot receive both a premium tax credit to help pay for the exchange coverage and COBRA premium assistance in the same month.
- A reduction in hours or involuntary termination of employment that follows an earlier qualifying event, such as a divorce, does make the qualified beneficiary from that first qualifying event an AEI.
- COBRA premium assistance is available to individuals who have elected and remained on COBRA continuation coverage for an extended period due to a disability determination, second qualifying event, or an extension under state mini-COBRA, to the extent those additional periods of coverage fall between April 1, 2021, and September 30, 2021, if the original qualifying event was a reduction in hours or an involuntary termination of employment.
- Retiree health coverage (that is not COBRA continuation coverage) offered to a potential AEI may affect COBRA premium assistance eligibility depending on whether the retiree health coverage is offered under the same GHP as the COBRA continuation coverage or under a separate GHP.
- Even if an individual makes or owes COBRA premium payments for retroactive COBRA continuation coverage elected under the Outbreak Period rules for which the payment due date has been extended, the individual may still receive premium assistance. Any late or unpaid premiums for retroactive COBRA continuation coverage will not affect an individual's eligibility for COBRA premium assistance.

An individual who is eligible for other group health plan coverage or Medicare is not an AEI.

Reduction in hours and involuntary termination of employment

In order to determine whether an individual is an AEI, an employer must confirm whether the individual has had a reduction in hours or an involuntary termination of employment. The Q&As confirm that if an individual is eligible for COBRA continuation coverage due to a reduction in hours, he or she may be an AEI regardless of whether the reduction in hours is voluntary or involuntary. Determining whether a termination of employment is voluntary or involuntary is based on all of the facts and circumstances, and not on how the employer labels the termination of employment. Employers should discuss the decision with legal counsel if any uncertainty exists.

- A reduction in hours that triggers COBRA, including furloughs or work stoppages, would cause a COBRA qualified beneficiary to be a potential AEI regardless of whether the reduction in hours is voluntary or involuntary.
- An involuntary termination of employment occurs when the employer terminates employment when the employee was willing and able to continue performing services.
- Involuntary termination can include:
  - Termination of an individual's employment while the individual is absent from work due to illness or disability, if there was a reasonable expectation that the employee would return to work after the illness or disability subsided
  - Termination for cause, unless the termination is due to gross misconduct (which is not a COBRA qualifying event)
  - Resignation due to a change in the geographic location of employment for the employee
  - Participation by an employee in a window program that meets IRS requirements under which employees with impending terminations of employment are offered a severance arrangement to terminate employment within a specified period of time
  - A termination of employment initiated by the employee in response to an involuntary material reduction in hours that did not result in a loss of coverage
  - An employer's decision not to renew an employee's contract, unless the parties understood at the time they entered into the contract that it was for specified

services over a set period of time and would not be renewed

- Involuntary termination generally *does not* include:
  - Retirement unless, absent the retirement, the employer would have terminated the employee's employment, the employee was willing and able to continue employment, and the employee had knowledge that he or she would be terminated
  - An employee's termination of employment due to general concerns about workplace safety, unless the employee can demonstrate that the employer's actions (or inactions) resulted in a material negative change in the employment relationship analogous to a constructive discharge
  - An employee-initiated termination of employment because a child is unable to attend school or because another childcare facility is closed due to the COVID-19 National Emergency
  - The death of an employee

Coverage eligible for COBRA premium assistance

The Q&As confirm that the COBRA premium assistance is available for any GHP that is subject to COBRA, excluding a health flexible spending account (FSA). While the Q&As specifically address vision and dental plans as well as health reimbursement arrangements (HRAs), the premium assistance would also be available for other GHPs that can be subject to COBRA, such as certain telemedicine benefits and employee assistance programs (EAPs).

- COBRA premium assistance is available for COBRA continuation coverage of any GHP, including vision-only plans, dental-only plans and HRAs, but not health FSAs provided through a section 125 cafeteria plan. It also includes individual coverage HRAs (ICHRAs). It may include retiree coverage if the retiree coverage is offered under the same GHP as the coverage made available to similarly situated active employees.

Beginning and end of COBRA premium assistance period

The burden is on the AEI to notify the plan if he or she is no longer eligible for COBRA premium assistance. Employers should ensure the ARPA premium assistance requirements are being administered in accordance with the applicable guidance, the terms of the plan, and the AEI's actual election for COBRA continuation coverage and the premium assistance, as it relates to when the premium assistance election begins and ends. This is particularly important since

Qualified beneficiaries who are AEIs and receive a notice of extended election periods only have 60 days from the date they receive the notice to elect COBRA continuation coverage.

an AEI is permitted to elect to have COBRA continuation coverage and the premium assistance start later than April 1, 2021, and some AEIs may be electing COBRA continuation coverage and the premium assistance after September 30, 2021, for eligible periods before that date.

- So long as an election for COBRA continuation coverage is made within the applicable 60-day election period, COBRA premium assistance is available through September 30, 2021, even if the election is made after that date.
- COBRA premium assistance is available until the earliest of (1) the first date the AEI becomes eligible for other GHP coverage (not including excepted benefits, a qualified small employer HRA or a health FSA) or Medicare coverage; (2) the date the individual ceases to be eligible for COBRA continuation coverage; or (3) the end of the last period of coverage beginning on or before September 30, 2021.
- Once COBRA continuation coverage with premium assistance ends, an AEI automatically continues COBRA without premium assistance, and the payment for the first period of coverage after September 30, 2021, will be timely if paid according to the terms of the plan and applicable COBRA continuation coverage requirements (taking into account any extensions under the Outbreak Period rules). Note that recent CMS guidance has clarified that the end of the COBRA premium assistance would result in a special enrollment period on the individual marketplace.

Extended election period and extensions under the Outbreak Period rules

The Q&As clarify that the Outbreak Period rules do not apply to ARPA's notice and extended election period requirements. Qualified beneficiaries who are AEIs and receive a notice of extended election periods only have 60 days from the date they receive the notice to elect COBRA continuation coverage. While the AEI is not required to elect retroactive COBRA continuation coverage in order to preserve his or her rights to the COBRA premium assistance, he or she must decide when electing COBRA continuation coverage eligible for premium assistance whether to elect or waive any retroactive coverage for periods of coverage before April 1, 2021.

If the AEI waives the retroactive coverage, he or she will *not* get another opportunity to elect the coverage, even if a later

election would have been permitted under the Outbreak Period rules.

- ARPA's extended election period applies only to a GHP that is subject to Federal COBRA and not continuation coverage provided only under state law.
- HRAs, for which an AEI has elected COBRA continuation coverage under ARPA's extended election period but declined to elect coverage that is retroactive to the COBRA qualifying event, may not reimburse expenses incurred after the qualifying event that led to the loss of coverage and before the first day of the first period of COBRA continuation coverage beginning on or after April 1, 2021.
- The employer may require an AEI who elects retroactive coverage for a period beginning before April 1, 2021, to pay the premiums for that period of COBRA continuation coverage consistent with the extended timeframes under the Outbreak Period rules. An individual who fails to timely pay any amount toward the premiums due for the retroactive COBRA continuation coverage may be treated as having not elected COBRA coverage until the first period of coverage beginning on or after April 1, 2021. If the individual pays only a portion of the total premiums due for retroactive coverage, the plan may credit those premiums to the earliest months of the retroactive COBRA continuation coverage and resume providing COBRA continuation coverage as of the first period of coverage beginning on or after April 1, 2021.

Calculation of COBRA premium assistance tax credit

Employer COBRA premium subsidies, such as those made available to a terminating employee through a severance package, can affect the amount of COBRA premium assistance that is available and thus the tax credit that an employer can claim. Since employers cannot claim a premium assistance tax credit for any severance-based COBRA premium subsidy they provide, they may want to consider with legal counsel changing how they provide severance benefits. If COBRA continuation coverage is being provided to non-AEIs or to individuals who are not entitled to federal COBRA, the employer should ensure that COBRA premium costs are properly allocated when determining the available ARPA premium assistance and claimed tax credit.

- The credit for the COBRA premium assistance under ARPA is equal to 102% of the applicable premium charged for COBRA continuation coverage to other similarly situated covered employees and qualified beneficiaries.
- If the employer subsidizes the cost of COBRA for similarly situated covered employees and qualified beneficiaries who are not AEIs, the amount of the premium assistance tax credit is the COBRA premium that would have been charged to an AEI in the absence of the ARPA premium assistance, and does not include any amount of subsidy that the employer would have otherwise provided.
- If the plan, which previously charged less than the maximum permitted COBRA premium, increases the premium for similarly situated covered employees and qualified beneficiaries, the ARPA COBRA premium assistance will apply to the increased premium amount. The same is true if the same plan also provided a separate taxable payment to the AEI.
- COBRA premium assistance is not available for individuals who are not AEIs nor entitled to federal COBRA.
- For an ICHRA, the credit is limited to 102% of the amount of eligible health care expenses actually reimbursed with respect to an AEI.

[Employers] need to accurately document AEIs and the amount of the COBRA continuation coverage premium assistance.

Claiming the COBRA premium assistance tax credit

Employer plan sponsors need to accurately document AEIs and the amount of the COBRA continuation coverage premium assistance in order to file the appropriate documents with the IRS to receive the premium assistance tax credit. In addition, employers need to collect and retain self-certification and attestation in the case of an IRS inquiry. Employers must maintain records substantiating eligibility for the tax credit generally for at least six years; however, they generally need not refund credits received for AEIs who failed to report their ineligibility for the premium tax credit. Employers should speak with their tax advisors about claiming the tax credit or requesting an advance of the anticipated credit.

- The "premium payee" for COBRA continuation coverage is eligible for the premium assistance tax credit. The premium payee is either (1) the multiemployer plan; (2) the employer maintaining the GHP that provides coverage that is subject to federal COBRA (whether fully insured or self-insured); or (3) the insurer providing coverage under a fully insured plan subject to state continuation coverage requirements or "mini-COBRA." The premium payee may also be a third-party provider and, in limited circumstances, a government of any state or political subdivision, or any agency or instrumentality thereof.

- The premium assistance tax credit can be claimed on designated lines of the federal payroll tax return (Form 941, Employer's Quarterly Federal Tax Return). Alternatively, the premium payee may (1) reduce the deposits of federal employment taxes, including withheld taxes, that it would otherwise be required to deposit, up to the amount of the anticipated credit; and (2) request an advance of the amount of the anticipated credit that exceeds the federal employment tax deposit available for reduction by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19.
- The premium payee must include any tax credit in its gross income for the taxable year, which includes the last day of any quarter with respect to which the credit is allowed.
- Employers wishing to claim a premium assistance tax credit will need to maintain records of an individual's self-certification or attestation as COBRA premium assistance eligibility, or other documentation substantiating eligibility.

Going forward

Employer plan sponsors should review the Q&As in the IRS notice and discuss their implications with their carriers/third-party administrators as soon as possible.

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SEC considering plans to address 10b5-1 plan rule issues

By Gary Chase and Steve Seelig

In a **June 7, 2021 speech** at the *Wall Street Journal's* CFO Network event, Securities and Exchange Commission (SEC) Chair Gary Gensler said that, at his direction, the SEC staff will provide recommendations on how to "freshen up" the more than 20-year-old 10b5-1 rules for insider stock sales. Gensler's speech suggests that proposed changes to these rules might come in the near term, but it appears those would be via the rulemaking process, with a public comment period before the rules are finalized.

Background

Although commonly thought to provide corporate insiders a safe harbor for stock sales, a 10b5-1 trading program only provides insiders an affirmative defense to a charge of insider trading on material nonpublic information. This defense can be overcome if the SEC demonstrates the trades under the plan were not entered into in good faith. For this reason, some companies already have in place as "best practices" some of the contemplated changes to help bolster their defense against possible SEC action.

Four main issues under consideration

Gensler identified four main issues that the staff is considering:

The SEC staff will provide recommendations on how to "freshen up" the more than 20-year-old 10b5-1 rules for insider stock sales.

1. **Create a cooling-off period before an initial sale after plan inception.** Under current rules, no waiting period is required between when a 10b5-1 sales plan is adopted and when the first stock sale can take place. Gensler noted that data indicates a significant number of sales under these plans happen within 30 or 60 days of a plan's inception. The staff is considering proposing a four-to-six-month waiting period.
2. **Limit cancellation of pending sales.** Current rules do not prevent an insider from canceling a previously scheduled sale under a 10b5-1 plan; Gensler believes this rule allows insiders to do so without risk of penalty even with knowledge of material nonpublic information. The staff is looking at rules on when and how these cancellations may take place.
3. **Require plan adoption, modification and cancellation disclosures.** Gensler did not elaborate on when and how these disclosures would be required but noted that

more disclosure could boost investor confidence. Many companies already provide details of 10b5-1 plan adoption using Form 8-K.

4. **Limit the number of plans.** There are currently no limits on the number of plans an insider can have. This means that an insider can have multiple sales agreements in place, choose the one that best meets his or her needs, then cancel the rest.

Going forward

The SEC has placed this issue on its Agency Rule List – Spring 2021 as an issue to be addressed through newly proposed amendments to existing regulations. This will involve a drawn-out process where the proposal will solicit public comments before being finalized. However, because the rules are specific to plan implementation, rather than a periodic filing disclosure like a proxy or 10-K, the final regulations may become effective shortly after publication rather than at a date in the future.

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SEC proxy advisor rules on hold

By Brian Myers and Steve Seelig

In September 2019, the Securities and Exchange Commission (SEC) issued guidance on applying proxy rules to proxy voting advisors;[1] in July 2020, it adopted amendments to be effective for the 2022 proxy season. However, on June 1, SEC Chair Gary Gensler asked the staff of the SEC Division of Corporate Finance to take a **comprehensive look** at whether those rules should remain in their current form or be revised. In response, the Division of Corporate Finance **announced** it would pause any actions to enforce those guidelines and regulations until it completes its review.

Soon after these statements were issued, the SEC and Institutional Shareholder Services Inc. asked a federal court to suspend a suit by ISS challenging the rules until the SEC review is completed.

The 2020 final regulations codify that proxy voting advice generally constitutes a solicitation and mandate that companies could rebut the voting advice as part of the transmittals provided by proxy advisors to institutional investors.

Many or most of these rules now may never be implemented in their current form. With the Biden administration's focus on climate change as well as environmental, social and governance (ESG) issues, this pause can be an opportunity to assess the role of proxy advisors in seeking actions in those areas.

One potential outcome is the SEC could decide that proxy advisors should continue to act as they have in the past, calibrating their voting methodologies in-house, based on the advice of their institutional investor clients.

Many or most of these rules now may never be implemented in their current form.

On the other hand, the SEC may decide to recalibrate its rules to include the issues proxy advisors must consider in offering their voting recommendations, for example, mandating that proxy advisors review ESG-related issues explicitly as part of their voting recommendations.

Employers should monitor the review process and prepare for potential outcomes, including SEC-mandated ESG disclosures.

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[1] See "**SEC guidance may change how companies interact with proxy advisors**," *Insider*, October 2019.

Washington's new long-term care payroll tax

By Maureen Gammon and Ben Lupin

Beginning January 1, 2022, employees in the state of Washington will be subject to a payroll tax of 0.58% on all earned income for the WA Cares Fund, the country's first state-run long-term care insurance program. Employers will be responsible for withholding the payroll tax from employee wages and for submitting payments and quarterly reports to the Employment Security Department (ESD).

In 2019, the **Long-Term Care Trust Act**, now known as the WA Cares Fund, was signed into law. It was amended on April 21, 2021, by **Substitute House Bill 1323**. The following Q&A provides further details for employers with employees working in Washington.

What is the WA Cares Fund?

The WA Cares Fund provides long-term care insurance for certain Washington residents. The program is funded through a payroll tax imposed on employees working in Washington, starting January 1, 2022. Employers make no contributions to the program. The premium contribution rate is initially set at 0.58% of all wages and remuneration, with no wage cap. "Covered wages" generally include commissions, bonuses and other taxable compensation. Beginning in 2024, the premium contribution rate will be adjusted every other year.

Benefits will be available to eligible individuals starting January 1, 2025. Eligible individuals are those employees who have paid premiums for either (a) 10 years without an interruption of five or more consecutive years, or (b) three years within the last six years. Employees must also have worked a minimum of 500 hours during the 10- or three-year time frames. Individuals currently retired or out of the workforce would not pay into the program and would not be eligible for the benefit.

Eligible services — such as adult day care, assisted living and nursing homes — will be reimbursed on a given date using "benefit units" of up to $100 per day (adjusted annually), up to a lifetime maximum benefit of 365 benefit units ($36,500). In order to receive benefits, individuals must be age 18 or older, reside in the state of Washington at the time of the claim, meet the minimum level of assistance with activities of daily living (e.g., eating, bathing or dressing) necessary to receive benefits through the program, and not have exhausted the lifetime limit.

The premium contribution rate is initially set at 0.58% of all wages and remuneration, with no wage cap.

Are there any exemptions from the payroll tax?

While most employees working in Washington will be required to make payroll contributions toward the WA Cares Fund, there are limited exemptions, including:

- Employees of the federal government
- Employees of federally recognized tribes, although the employer may elect for its employees to participate
- Employees and employers who are parties to a collective bargaining agreement in existence as of October 19, 2017, unless and until the agreement is reopened, renegotiated or expires
- Self-employed individuals, although they are permitted to opt in if they meet certain requirements
- Certain employees who purchase qualifying long-term care insurance before November 1, 2021, and submit the required application (and have the application approved by the state) in a timely manner (see below)

How do eligible employees apply for an exemption?

An employee who has qualifying long-term care insurance in effect before November 1, 2021, and attests to that fact may apply for a permanent exemption from the payroll tax. Note that unless the law is amended, an employee who does not enroll in long-term care insurance until after the November 1 deadline will not be eligible to opt out. The employee must be 18 years of age or older on the date he or she applies for the exemption. Applications for an exemption will be accepted electronically only from October 1, 2021, through December 31, 2022. After the employee's application is processed, the employee will receive an approval or denial letter. If the application is approved, the employee must notify any current or future employer of his or her exempt status and provide the employer a copy of the approval letter, which the employer must maintain on file. The exemption is effective as of the first quarter following the approval, and premium

deductions should cease at that time. An employee who fails to notify the employer of an exemption is not entitled to a refund of any premium deductions made before notification is provided. An employee who is approved for an exemption is permanently ineligible for benefits from the WA Cares Fund.

What long-term care insurance qualifies an employee for the exemption?

The implementing regulation defines long-term care insurance as an insurance policy, contract or rider that is advertised, marketed, offered or designed to provide coverage for at least 12 consecutive months for a covered person. It may be on an expense incurred, indemnity, prepaid or other basis, for one or more necessary or medically necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. It includes any policy, contract or rider that provides for payment of benefits based upon cognitive impairment or the loss of functional capacity. It also includes group and individual annuities and life insurance policies or riders that provide directly or supplement long-term care insurance. It does not include any insurance policy, contract or rider that is offered primarily to provide coverage for basic Medicare supplement, basic hospital expense, basic medical-surgical expense, hospital confinement indemnity, major medical expense, disability income, related income, asset protection, accident only, specified disease, specified accident or limited benefit health.

What are employers required to do?

Employers are required to withhold the appropriate salary reductions from employees' wages each pay period starting January 1, 2022. Employers must then submit payments and quarterly reports to the ESD by the last day of the month after the end of the calendar quarter. Employers are also required to stop payroll contributions when provided an exemption approval letter from an employee and also maintain copies of the approval letters. An employer is not required to notify employees about the WA Cares Fund but should consider doing so, particularly in regard to the payroll deductions that will start in 2022. The employer can also inform employees about the opt-out requirements so that employees with qualifying coverage can take the necessary steps to opt out when the application process opens in October 2021. Earlier notification from an employer could also give employees an opportunity to find and purchase long-term care insurance ahead of the November 1, 2021 deadline and avoid the payroll tax. Washington has started to provide information about the **WA Cares Fund**, but the ESD's timeline indicates that outreach efforts for employees will not happen until later in 2021. Providing more advance notice of these new requirements may be particularly important to employees given their limited opportunity to opt out.

Employers should prepare for the employee payroll deductions and related reporting that will start in 2022.

What should employers consider doing now?

1. Employers should prepare for the employee payroll deductions and related reporting that will start in 2022, which may include confirming that their payroll vendor is making the necessary changes to enable them to start collecting the contributions and submitting the reports when required.
2. Employers should consider providing information to employees about the WA Cares Fund, including information about the payroll deductions and upcoming deadline for the opt-out exemption.
3. Employers will want to be sure that they have an internal process in place to collect opt-out approval letters from employees, to cease payroll contributions for any employee who provides an opt-out approval letter and to retain copies of any opt-out approval letters they receive.
4. Employers considering offering long-term care insurance to their employees so that employees can opt out of the WA Cares Fund will need to act quickly to ensure that the coverage is effective before November 1, 2021. It is important to note that unless the law is amended, there will be no opportunity for employees to opt out of making payroll contributions if they enroll in long-term care insurance on or after November 1, 2021.

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Potential impact of American Families Plan on executive compensation

By Stephen Douglas, Bill Kalten and Steve Seelig

On April 28, the Biden administration released a **fact sheet** with more details on its American Families Plan, including important implications for executive compensation. The plan proposes to increase the long-term capital gains tax rate for "households making over $1 million" from the current 20% top rate to 39.6%, the same rate proposed for the top ordinary income tax rate. The capital gains rate would remain the same for those earning under $1 million. When calculated with the 3.8% surtax on net investment income, which applies to investors with modified adjusted gross income (MAGI) above $200,000 ($250,00 married and filing jointly), this would mean a top long-term capital gains rate of 43.4%.

The American Families Plan proposal would also eliminate the current rule that permits a step-up in basis of unrealized capital gains at death, which has meant that appreciation for inherited property is never subject to capital gains tax. Recent statements from the administration indicate those gains would be taxed immediately at death, subject to a $1 million exemption for each beneficiary ($2.5 million per couple when combined with existing real estate exemptions).

The American Families Plan proposal is separate from President Biden's proposal to fund his infrastructure plan by increasing the top corporate tax rate from 21% to 28%. This increase would be paired with a doubling of the global minimum corporate tax to 21%.

In addition, if the Biden campaign promise to apply Social Security payroll taxes to earnings above $400,000 is enacted, this would mean the 6.2% tax would continue to be applied to wages up to the taxable wage base (currently $142,800) and then would recommence for wages above $400,000. The Medicare tax of 1.45% would continue to apply to all wages, along with the additional Medicare tax of 0.9% on wages above $250,000.

Divergent tax rules

If such divergent tax rules are enacted, the following principles illustrate how short-term goals might compete with long-term planning:

- When ordinary income tax rates are set to increase, conventional wisdom would suggest paying out compensation early to avoid that increase.

The plan proposes to increase the long-term capital gains tax rate for "households making over $1 million."

- With higher ordinary income tax rates, it often makes sense to defer compensation payments (and taxation) until a future year so that earnings can build up tax-free and payments can be in a year when a recipient has a lower marginal tax rate.
- A pending increase in capital gains tax rates typically prompts property and stock sales in the year before the change is implemented, particularly when unrealized appreciation in those holdings would be taxed immediately at death rather than having an automatic step-up in basis that would otherwise discourage the need for those sales.
- Those sales may not take place for some taxpayers; however, if those sales raise income for the year of sale, that in turn could push the individual above Biden's proposed $1 million threshold and into the higher capital gains rate for the following year. This would depend on whether the $1 million trigger is based on prior-year income.
- Avoiding the higher capital gains rate would encourage individuals who are modestly above the $1 million threshold to reduce their compensation in the year income is measured for the $1 million threshold by deferring more compensation.
- Larger deferred compensation balances could encourage an annuity payment regime if that would help reduce income below $1 million for payments made postretirement; however, this might not work where non-qualified deferred compensation (NQDC) payments annually would bring income over $1 million for each annuity year. These high-benefit individuals might take a lump sum to be subject to the higher capital gains rates only for a single year.
- The 3.8% net investment income surtax does not apply to deferred compensation held by the company. This means that an individual with more than $1 million in income would pay a 3.8% higher tax rate on appreciation, dividends and other earnings on capital assets than he or she would on those assets that appreciate within a company-held NQDC plan, which would be taxed only at the 39.6% ordinary income rate.

The existing tax code rules do not allow for flexibility in timing compensation payments. Internal Revenue Code (IRC) section 409A requires specific form and timing of payment elections for existing deferrals of compensation, such as excess 401(k) plans and deferred restricted stock units. It also limits changes in distribution form and timing unless done several years in advance.

The 2017 Tax Cuts and Jobs Act (TCJA) made the IRC section 162(m) limit on corporate tax deductions to the first $1 million of compensation paid to any "covered employee" much more difficult to plan around. The TCJA amendment means that anyone who is a "covered employee" for a single corporate tax year will always be a "covered employee," no matter when compensation is paid, including postretirement and after death. Gone also is the exclusion for qualified performance-based compensation and commissions. A TCJA "grandfather" rule does permit companies to ignore the $1 million pay cap for compensation payments made under a binding written contract in place as of November 2, 2017, but this means those agreements cannot change payment date form and timing without losing that treatment.

Planning for 2021

Companies may want to consider the following actions, assuming that ordinary income tax rates, capital gains rates and corporate tax rates would increase starting in 2022, and that the company has a calendar-year fiscal year:

1. **Pay annual bonuses before 2021 year-end:** For 2021, companies could pay their annual bonuses before the end of the year based on best estimates of financial performance known at that time, rather than within two and a half months of year-end. For executives, this would cause accelerated payments to be taxed at a 37% income tax rate instead of the increased 39.6% rate.

   Processes would need to be in place to avoid overpaying executives before year-end based on actual year-end results evidenced in the audited financials. Proxy disclosure would not change, in that the Summary Compensation Table reports bonuses earned during a fiscal year, without regard to the actual payment date. Companies would need to determine if any footnote or other disclosures in the Compensation Discussion and Analysis are warranted.

   FICA taxes also could be reduced with the early bonus payment, particularly if the proposal to subject wages above $400,000 to social security tax is also enacted for 2022.

   While early bonus payments could yield tax savings for the individual, this must be balanced against the smaller tax benefit the company could receive if its corporate tax rate was to increase. Paying early would yield a less valuable deduction, based on a maximum 21% rate for 2021, compared with a more valuable deduction at a maximum of 28% if the corporate rate increases go through.

2. **Terminate and liquidate NQDC during 2021:** A company could accelerate the payment date of existing NQDC to sometime during 2021 to avoid the ordinary income tax increase; however, section 409A generally permits early distributions only if the company terminates and liquidates all plans of the same type (e.g., all defined benefit-type) and does not start any new plans of that type for two years. Section 162(m) issues would also arise both for grandfathered plans and for the potential lost deduction for immediate payments. The potential corporate tax implications would need to be modeled before a termination/liquidation is undertaken.

3. **Accelerate vesting and payment of equity during 2021:** Section 409A generally allows early vesting, but a company should consult with shareholders and proxy advisors before moving forward with this alternative.

The American Families Plan proposals, if enacted, could make deferrals of future compensation more popular.

Expanding NQDC programs for 2022 and beyond

The American Families Plan proposals, if enacted, could make deferrals of future compensation more popular, with the dual benefit of compounded interest on untaxed savings plus the potential to delay those payments until an individual's ordinary income tax rate drops to the next level down. (Note: Companies seeking to change NQDC payment terms and timing for existing deferred compensation should remain aware of the restrictions in section 409A and the potential loss of grandfathered treatment under section 162[m]):

1. **Deferrals could help avoid the net investment income tax on other assets:** Employee deferrals could help those near the $200,000/$250,000 MAGI threshold to stay below those levels to avoid the 3.8% net investment income tax on employee-owned assets.

2. **Deferrals themselves could avoid the net investment income tax:** Deferring compensation in an employer NQDC could avoid the 3.8% net investment income tax on earnings and dividends.

3. **Deferrals could help avoid the increased capital gains rate:** Deferring compensation could help employees stay below the "household makes over $1 million" level that would trigger the increased capital gains rate. This would require employees to forecast when they will need to sell capital assets (including company stock), meaning deferral rates could change from year to year. Employees would also need to forecast whether capital gains recognized for a given year would themselves be additive to the $1 million threshold calculation.
4. **Distribution timing could help avoid the increased capital gains rate in future years:** While deferrals could help avoid the $1 million trigger during an employee's working years, distribution timing would help determine if the threshold is exceeded in future years, including postretirement. Optimally, distribution timing would be crafted so that household income would always avoid exceeding that $1 million level.
5. **Distribution timing also could help avoid the 162(m) $1 million compensation limit on company deductions:** Delaying distributions could help companies avoid the section 162(m) $1 million pay cap for future payments to "covered employees." As previously discussed, any compensation payments in any year (even postretirement and post-death) to a "covered employee" count toward the $1 million deduction limit. Although measuring $1 million in compensation under 162(m) (total compensation paid) differs from the $1 million per household capital gains rate threshold, keeping each of those calculations under $1 million for any distribution year could help both parties.

   Nonetheless, companies will have executives whose NQDC balances or benefits would be over $1 million even if distributed in the form of installment payments. It might be preferable for these executives to take their NQDC distribution in a lump sum.

Employers should be prepared to help higher-paid employees with tax planning flexibility within their compensation programs.

6. **Defer payment of equity grants and/or offer more stock options:** Many companies already offer the ability to defer payment of restricted stock units or performance shares until a future year, but often they limit the percentage of compensation earned for which deferral is permissible and/or they limit the timing of when the deferral must be paid. As noted above, the new rules taken together suggest it could be helpful to add or enhance these deferral programs.

   Stock options and stock appreciation rights create more flexibility for executives to time their income tax inclusion, but most programs make grants with only a 10-year term and/or require exercise soon after separation. This means the deferral opportunities discussed above might not be available under current plan designs.

Going forward

Employers should be prepared to help higher-paid employees with tax planning flexibility within their compensation programs. Employers should also begin considering steps that might be required if these proposed and potential tax law changes become enacted.

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