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Employee Benefit Plan Review

Ask the Experts

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FMLA "Worksites"

Q I am trying to determine whether some of our employees are eligible for Family and Medical Leave Act (FMLA) benefits. To do that, I need to determine the worksite of each employee. How do I make that determination for employees who are frequently traveling and for those of our employees who we have allowed to work from home?

A Under the FMLA, an employee is not eligible for FMLA benefits if the employer has fewer than 50 employees within 75 miles of the employee's worksite. As a result, it is important for employers to understand where their employees' worksites are. Most of the time, this is an easy determination. The FMLA regulations state that an employee's worksite under the FMLA will ordinarily be the site to which the employee reports for work. The regulations go on to define the worksite for employees with no fixed worksite (such as truck drivers, pilots, and some salespersons). For these employees, their worksite is the site to which they are assigned as a home base, from which their work is assigned to them, or to which they report. For example, for transportation employees, the regulations state that their worksite is the terminal to which they are assigned and report for work, from which they depart, and to which they return after completion of a work assignment. Finally, the regulations provide that an employee's home is generally not a worksite. So, for employees who work from home, their home is not their worksite. Rather, the regulations provide that their worksite is the office to which they report and from which assignments are given.[1]

Tax Deduction for ESOP Dividends

Q My company, a C corporation, has an employee stock ownership plan (ESOP) for its employees. What are the requirements for my company to be able to take a tax deduction for dividends that the company pays with respect to employer securities in the ESOP?

A Under Internal Revenue Code (Code) Section 404(k), a C corporation may take a deduction for a taxable year for the amount of any "applicable dividend" paid in cash by such corporation with respect to "applicable employer securities." "Applicable employer securities" means, with respect to any dividend, employer securities which are held on the record date for such dividend by an ESOP which is maintained by the corporation paying such dividend, or any other corporation which is a member of a controlled group of corporations which includes such corporation. An "applicable dividend" means any dividend which, in accordance with the ESOP plan provisions, (i) is paid in cash to the participants in the plan or their beneficiaries, (ii) is paid to the plan and is distributed in cash to participants in the plan or their beneficiaries not later than 90 days after the close of the plan year in which the dividend is paid to the plan, (iii) is, at the election of such participants or their beneficiaries, payable as provided in clause (i) or (ii), or paid to the plan and reinvested in qualifying employer securities, or (iv) is used to make payments on an ESOP loan,

the proceeds of which were used the acquire the employer securities with respect to which the dividend is paid. Note that condition (iv) in the prior sentence will not be satisfied with respect to any employer security unless the plan provides that employer securities with fair market value of not less than the amount of such dividend are allocated to such participant for the year in which the dividend would have been allocated to the participant.[2] An ESOP may, but is not required, to allow participants to elect to receive dividends in one or more of these forms.

In order for ESOP dividends subject to an election to be "applicable dividends" under Code Section 404(k), the election must be provided in a manner that satisfies the following requirements: (a) a participant must be given a reasonable opportunity before a dividend is paid or distributed to the participant in which to make the election, (b) a participant must have a reasonable opportunity to change a dividend at least annually, and (c) if there is a change in the plan terms governing the manner in which the dividends are paid or distributed to participants, a participant must be given a reasonable opportunity to make an election under the new plan terms prior to the date on which the first dividend subject to the new plan terms is paid or distributed. An ESOP will not fail to comply with these notice requirements merely because it provides that, if a participant fails to make an affirmative dividend election, one of the options offered to participants is treated as a default election. Participants must be fully vested in dividends with respect to which a corporation claims a deduction under Code Section 404(k). Note that the Internal Revenue Service (IRS) is authorized to disallow any dividend deduction that constitutes an avoidance or evasion of taxation, which includes the authority to disallow a deduction for unreasonable dividends. Otherwise, a C corporation that pays an ESOP dividend for any of the reasons noted above should be able to take a tax deduction for those dividends paid, subject to the requirements of Code Section 404(k) and applicable IRS guidance thereunder.

Severance and 401(k) Plan Deferrals

Q Our 401(k) plan allows deferrals from "compensation," with the definition of "compensation" being tied to wages on box 1 of the Form W-2. We report severance payments in box 1 on the Form W-2, yet our outside administrator is telling us that we cannot withhold deferrals from those severance payments. Is that correct? That seems counter to the reason that we have been using the "box 1" definition of compensation under our plan—simplicity.

A Yes, it is correct, subject to making sure that we are speaking about the same types of payments when your question refers to "severance." Tax regulations issued under Section 415 of the Internal Revenue Code provide that, in order for payments to be includible as "compensation" under a 401(k) plan, those payments must be made to the employee before termination of employment. Of course, there are exceptions to this rule. The first exception is for amounts that are compensation for services rendered and that would have been paid anyway even if the employee's employment had not terminated. Examples include an employee's final paycheck that does not get issued until after the employee's termination date, or a bonus that was earned and is subsequently paid out and it is only because of happenstance that the bonus payment date is after the employee's termination date. The second exception is for amounts paid as a cash-out of accrued but unused paid employee leave time (such as vacation) that the employee could have used had he or she remained employed. The third exception is for payments of nonqualified deferred compensation that would have been paid at the same time even if the employee's employment had not terminated.

For each of the exceptions, the payment must be made within the applicable time frame, which is the later of two-and-a-half months after the employee terminates employment and the end of the "limitation year" (often, the plan year) in which the employee terminates employment. If the conditions of these exceptions are met, then your "severance payments" may be includible in compensation. You will want to carefully review how your plan document defines "compensation," as not each of these amounts are required to be includible in the definition of "compensation" (the distinction is between permissive and mandatory). However, any other post-employment compensation, including what many think about when they use the term "severance" (e.g., a certain amount or number of weeks of pay that one receives upon termination of employment, usually in exchange for signing a release of claims), may not be included in the definition of "compensation" and, therefore, may not have amounts withheld from and deposited into the 401(k) plan, even though the severance payment will be reported in box 1 of the Form W-2.

COBRA Continuation Coverage Rights If Company Terminates Group Health Insurance Plan

Q My company may be filing for bankruptcy and terminating all of our employees, as well as terminating our sole group health insurance plan. If we do this, will the terminated employees have COBRA continuation coverage rights?

A It depends. The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) is a federal law that generally applies to all private-sector group health plans maintained by employers that had at least 20 employees on more than 50 percent of its typical business days in the previous calendar year. COBRA

requires group health plans to offer continuation coverage to covered employees, former employees, spouses, former spouses, and dependent children when group health plan coverage would otherwise be lost due to certain events, including, without limitation, a covered employee's job loss or reduction in hours for reasons other than gross misconduct. COBRA sets rules for how and when plan sponsors must offer and provide continuation coverage, how employees and their families may elect continuation coverage, and what circumstances justify terminating continuation coverage. The group health plan of an employer in bankruptcy proceedings continues to be subject to COBRA during the course of the bankruptcy. Although actions against the employer are automatically stayed when an employer declares bankruptcy, actions against a benefit plan sponsored by the employer or against plan fiduciaries for fiduciary breach are not subject to the automatic stay. If your company is subject to COBRA, even after your company terminates its group health insurance plan, if another member of your company's controlled group maintains any group health plan, the terminated employees will have COBRA continuation coverage rights under that plan (as will other COBRA qualified beneficiaries). If your company has retiree health coverage and is filing for Chapter 11 bankruptcy, note that both the Bankruptcy Code and COBRA contain special rules for retiree health plans that would need to be analyzed separately.

For example, the Bankruptcy Code restricts termination of retiree health plans in Chapter 11 bankruptcies, and prevents employers from reducing or eliminating health plan payments to retirees from any health plan pre-dating the bankruptcy filing (1) without permission from the court, or (2) after the reorganization is completed. A court will not approve reduction or termination of retiree health benefits unless it is established that the changes are necessary for the reorganization and are fair in comparison to the impact of the proceedings on other parties. COBRA also has special rules for Chapter 11 bankruptcies and covered retirees and their family members.

Note also that, if your company reorganizes through a stock sale or asset sale, if the selling group ceases to provide any group health plan to any employee in connection with the sale, the buying group may become a "successor employer" that is obligated to provide COBRA coverage under any group health plan maintained by the buying group, in accordance with COBRA's rules (and may become a "successor employer" under COBRA even if the reorganization is in connection with a bankruptcy proceeding). If there is no successor employer, COBRA coverage ends on the date on which an employer (and any controlled group member) ceases to provide any group health plan to any employee. If your company terminates its group health insurance plan, and no other member of your company's controlled group maintains a health insurance plan, the employees who are terminated simultaneously with the termination of the group health insurance plan will not have any COBRA rights, as there would be no plan under which to continue coverage through COBRA. If all controlled group health plans are terminated, the plan administrator is required to provide a notice of termination to any qualified beneficiaries who are currently on COBRA and who will be losing COBRA coverage before the end of the maximum coverage period as a result of the plan termination. This notice must be provided to the qualified beneficiaries as soon as practicable following the decision to terminate COBRA coverage. Once plan coverage is terminated, there should be no obligation to provide COBRA election notices to new qualified beneficiaries.

In addition, many states have enacted state continuation of coverage laws that are similar to or in many cases more favorable to employees. It is important to review state law requirements as well. ❂

Notes

1. *See generally* 29 C.F.R. Section 825.102 & 825.111.
2. For more information, see Code Section 404(k).

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