

Employee Benefits Broadcast

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September 20, 2018



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Today's Speakers



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Today's Agenda

- **Incentive Stock Options: A Review and Fresh Perspective in a New Tax World**
- **Health Plan Spotlight: Consider Refiling Your ACA Tax Forms If You Made Either of These Common Tax Reporting Mistakes, and a Basic Survival Guide for an HHS Audit**
- **Tips for Drafting an Effective and Compliant Employee Handbook (Including How to Address Employee Benefits)**

Incentive Stock Options: A Review and Fresh Perspective in a New Tax World

Overview

- What are ISOs?
- How are they treated for tax purposes?
- Why would we use them - Then and Now?

What is an ISO?

- Incentive Stock Option
- A special type of stock option
 - Sometimes called a “statutory stock option” because it is established pursuant to Internal Revenue Code Section 422
- Option = The right to purchase shares of company stock later for “today’s” price
- Why special? If structured and managed correctly, ISOs may result in more favorable tax treatment to the executive (but not the company) than a normal option

Plan

- Must be issued pursuant to a plan
- Plan must provide:
 - # of shares reserved for issuance as ISOs
 - Only employees eligible for ISOs
- Approved by shareholders within 12 months before or after adoption and each 10 years thereafter
- May describe whether may be exercised by cash payment or tendering previously owned shares

Award Agreement

- Exercise price of at least FMV (110% for 10% shareholders) as of grant date
- 10-year maximum term (5 years for 10% shareholders)
- No more than \$100,000 may become exercisable in any given calendar year (based on FMV of stock on the grant date)
 - *Example:* On grant date, stock has FMV of \$10. Employer grants ISOs with respect to 40,000 shares (aggregate of \$400,000). Options vest 25% on each of the first four anniversaries of the grant date. Since only \$100,000 is vesting in any given year, ISO limit is met.
 - Excess is automatically a non-qualified stock option (not eligible for “special” tax treatment).

Other Requirements

- Limits on post-termination exercise period
 - Big one = Three months after other terminations; different rules apply to disability and death.
 - If option exercised after three months, treated similar to a non-qualified stock option.
- Holding period for stock applies
 - Two years after option grant and one year after exercise.
 - If not met, treated similar to a non-qualified stock option.

Tip: Communication strategy is important.

“Special” Tax Treatment – Employee

Basic Idea = No ordinary income tax at exercise, may be eligible for long-term capital gains rate on difference between exercise price and sale price. Catch is that may trigger AMT.

Type	ISO	NQSO
Grant	No tax consequences	
Exercise	<p>No regular income tax is owed (unless treated as a nonqualified option). No FICA or withholding.</p> <p>However, the excess of the stock’s fair market value over the option price – i.e., “spread” – may trigger an alternative minimum tax (AMT) obligation.</p>	<p>The excess of the stock’s fair market value over the option price is taxed as ordinary income and is subject to FICA and income tax withholding (if employee).</p> <p>Practical Challenge = How to collect FICA and withholding? Employee may have to write a check for the exercise price AND these amounts.</p>
Sale	<p>If holding period is met, then gain (<i>i.e.</i>, excess of sales price over exercise price) is taxed at long-term capital gains rate. No FICA or withholding.</p> <p>If holding period is not met, then the spread (from grant to exercise) is ordinary income; remainder is short or long-term capital gains (like a NQSO).</p>	<p>Any appreciation occurring after calculation of the exercise tax obligation is taxed as either short or long-term capital gains.</p>

“Not-So-Special” Tax Treatment - Company

Basic idea = Company does not get a deduction, if all goes as planned.

Type of Option	ISO	NQSO
Grant	No tax consequences.	
Exercise	No tax consequences.	Deduction allowed for the amount the employee recognizes as taxable income in the year employee is taxed. FICA and withholding obligations apply.
Sale	<p>If holding period is met, no tax deduction is allowed for an ISO (at either exercise or sale). No FICA or withholding.</p> <p>If holding period is not met, then the company may deduct the “spread” as measured at exercise in the year of the sale.</p>	No deduction allowed.

Historic Opinion of Many? ISOs are not worth it.

- Complicated tracking and tax reporting
 - Holding period; \$100,000 limit
- Many employees trigger AMT in year of exercise
 - Greater risk for successful start-ups – significant spread at exercise
- Few employees even satisfy the holding period
 - When do employees *really* exercise?
- Company doesn't get a deduction for significant compensation expense
 - May be less of a concern for start-ups and large public companies, where the deduction on exercise is not particularly valuable

Has this changed?

- Maybe, but probably not on a large scale
- Some practitioners think that the changes made by the Tax Cuts & Jobs Act will lead to more ISOs:
 - Changes to the AMT make it less likely that ISOs will trigger AMT (savvy employees may make more requests)
 - Long-term capital gains rates (15% and 20%) have not changed (even though ordinary income rates were reduced, the difference, especially for higher income tax payers is still meaningful)
 - Corporate tax rates were reduced (making the compensation deduction less valuable)

Ongoing Challenges?

- Many of the same challenges as before...
 - Not well understood or managed
 - AMT is still possible, just less likely
 - Holding Period
 - \$100,000/yr limit – Limited value for top execs
- Still important to understand when reviewing compensation strategy and/or negotiating with executives

Health Plan Spotlight: Refiling Your ACA Tax Forms and Basic HIPAA Survival Guide

ACA Tax Reporting - Background

▪ MythBusters – ACA Style

- “Isn’t the employer mandate going away?”
 - Employer mandate is still law, and will likely remain for the foreseeable future (individual mandate zeroed out eff. 1/1/19)
- “I thought we don’t have to do the ACA tax forms anymore.”
 - ACA tax reporting requirements still apply, and will likely remain (in some form) for the foreseeable future
- “The Trump Administration is not enforcing the ACA.”
 - IRS is enforcing the employer mandate, even under new administration
- “If I don’t report, they can’t find me.”
 - IRS sending out letters to non-filers, and separate penalties apply

Employer Mandate Background (2016 and beyond)

▪ 95% Offer Requirement – Sledgehammer Penalty

- Offer health coverage to at least 95% of full-time employees and dependents
 - Penalty → **\$2,000** annually (indexed; 2018 – \$2,320) per **each and every** FTE, if one FTE gets subsidized Marketplace coverage (minus first 30 FTEs)

▪ “Affordability” Requirement – Tack Hammer Penalty

- Coverage must be “affordable” (and provide minimum value)
 - Penalty → **\$3,000** annually (indexed; 2018 - \$3,480) **but only** for those FTEs **who actually** enroll in subsidized Marketplace coverage

ACA Tax Forms Background

- ACA tax forms used by IRS to determine employer mandate compliance
- **Form 1094-C:** Reports 95% Offer Compliance
 - Just one form submitted to IRS as a cover page
- **Form 1095-C:** Reports Affordability Compliance
 - Must be furnished to (at least) each FTE and copies submitted to IRS
 - Similar to W-2 reporting

Reporting Error #1 – Checking the “No” Box

- Form 1094-C asks if you complied with 95% offer requirement
 - Check a box “yes” or “no”

Form 1094-C (2017)

		(a) Minimum Essential Coverage Offer Indicator		E
		Yes	No	
23	All 12 Months	<input type="checkbox"/>	<input type="checkbox"/>	

Reporting Error #2 – Failing to Report Safe Harbors and Other Relief

- Form 1095-C asks you to report why you are immune from Tack Hammer (Affordability) penalties

Part II Employee Offer of Coverage			
	All 12 Months	Jan	Feb
14 Offer of Coverage (enter required code)			
15 Employee Required Contribution (see instructions)	\$	\$	\$
16 Section 4980H Safe Harbor and Other Relief (enter code, if applicable)			

- Indicate affordability safe harbor or why other relief might apply (e.g., waiting period, not an employee, not FTE)

HHS Audits/Investigations – HIPAA

- MythBusters – HIPAA Style
 - *“HHS just cares about hospitals, not employer health plans.”*
 - HHS enforces HIPAA against employer health plans
 - *“We don’t have any PHI – our TPA has it all – so we are all good.”*
 - If you have self-funded health plans, you have HIPAA obligations regardless of the amount of PHI maintained internally
 - *“We fully comply with HIPAA privacy – done!”*
 - HIPAA security requirements are just as important; same penalties apply

Basic Requirements for Surviving an HHS Audit/Investigation

- Privacy policies and procedures
- Security policies and procedures
- Signed business associate agreements with vendors/TPAs
- Notice of privacy practices
- Risk analysis
- Risk management plan

This is not a comprehensive list of all HIPAA requirements. These are just some of the major items (but not all) that HHS typically examines.

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Tips for Drafting an Effective and Compliant Employee Handbook (Including How to Address Employee Benefits)

“Dos” for Employee Handbooks

- Provide an overview of your company – history, mission, products/services, values
- Draft the handbook so that it is easy to read and user friendly
- Contain disclaimers
 - Employment is “at-will”
 - Does not and is not intended to create a contract of employment
 - Guidelines, not definitive for every issue
 - Policies may be revised, modified or revoked at any time with or without notice
 - Replaces all other handbooks or similar materials which have been published/distributed
- Set forth expectations for employees
 - Attendance, Conduct, Discipline
 - Retain flexibility

“Dos” for Employee Handbooks

- Obtain a Written Acknowledgment from Employee
 - Receipt, review and understanding of handbook
 - At-will status
 - Not an employment contract
- Apply the policies consistently
- Consider state specific supplements
- View as a potential exhibit in litigation
- Review and update regularly
 - Obtain the assistance of IT, HR, Employment Counsel

“Don’ts” for Employee Handbook

- Don’t take a “cookie-cutter” approach
 - One size may not fit all
- Don’t use language that could be interpreted to create a promise
- Don’t have overly restrictive policies – leave room for full discretion by employer
 - Any list should be non-exhaustive
- Don’t forget state and local law considerations
 - Paid sick leave
 - Jury duty
 - Nursing mothers
- Don’t be too specific on employee benefits (more later)
- Don’t forget to train supervisors

NLRB Guidance

- December 2017: new standard for employee handbook provisions, now a balancing test (*The Boeing Co.*, 365 NLRB No. 154)
 - No longer “reasonably construed”
 - Look to the nature and extent of the potential impact on NLRA rights
 - Consider legitimate justifications associated with the rule
- Can the employer demonstrate that business reasons outweigh any potential negatives?
- Memorandum “Guidance on Handbook Rules Post-*Boeing*” issued June 6, 2018
 - Helpful guidance for drafting / updating handbooks
 - Standard for enforcement
 - Ambiguities no longer interpreted against the employer
 - Collective sigh of relief from employers

NLRB Guidance (continued)

- Category 1: Rules that are *generally* lawful to maintain (examples include)
 - Civility rules
 - Rules prohibiting photography or recording
 - Insubordination / Uncooperative with supervisor / Conduct that adversely affects operations / Disruptive behavior
 - Confidential, proprietary, customer information or documents
 - Defamation or misrepresentation
 - Use of employer logo / intellectual property
 - Authorization to speak for the company
 - Disloyalty
- Category 2: Rules warranting individualized scrutiny (examples include)
 - Broad conflict-of-interest rules / Broad confidentiality rules encompassing “employer business” or “employee information”
 - Rules regarding disparagement or criticism of the employer / rules against making “false or inaccurate statements”
 - Rules generally restricting speaking to the media or third parties
- Category 3: Rules that are unlawful to maintain (examples include)
 - Confidentiality rules specifically regarding wages, benefits, or working conditions
 - Rules against joining outside organizations or voting on matters concerning employer

Policies that may need updating

- Anti-harassment Policy in the era of #MeToo
 - Comprehensive policy with broad reach
 - Define prohibited conduct with examples
 - Protected categories
 - Expressly state company's prohibition of and commitment to maintaining a workplace free of prohibited harassment and discrimination
 - Explain exactly how and to whom employees can bring complaints
 - Multiple channels – not just supervisor
 - Executive level or Board of Directors
 - Include names, telephone numbers, email address, both genders
 - All complaints will be promptly and thoroughly investigated
 - Confidentiality to the extent possible
 - Anti-retaliation provision

Policies that may need updating

- Leave policies
 - Family and Medical Leave Act
 - Covered employers must inform employees of their rights, including eligibility
 - Paid Sick Leave
 - State and local laws
 - Parental Leave
 - Bonding time for birth, adoption or fostering applies to all parents and should be the same for men and women, while birth mothers may still have some additional time off based on disability
 - You don't want a policy that invites a claim of disparate treatment on the basis of sex, sexual orientation, familial relations, or some other protected category

Policies that may need updating

- Prohibiting discrimination against LGBT employees
 - State and local laws
 - Inclusive workplace
- Reasonable accommodations
 - Requests for leave under the Americans with Disabilities Act
 - Continuing leave beyond FMLA's 12 weeks
- Drug Testing
 - Marijuana – medical and/or recreational use
 - Evolving statutory and case law
 - Claims under state disability law

Policies that may need updating

- Confidentiality Policy
 - Do not disclose confidential financial data, or other non-public proprietary company information
 - Information concerning customers shall not be disclosed, directly or indirectly
- Social Media Policy
 - Disclaimer that an employee's opinions on social media are the employee's own and do not necessarily represent the company
- Weapons Policy
 - State laws permitting employee to keep a licensed firearm in their vehicle in the employer's parking lot

Employee Benefits

- Provide a general and brief overview of benefits that are offered
 - Subject to eligibility requirements of the employee
 - Subject to eligibility requirements of the individual plan
- Avoid specifics as benefits may change from year to year
- Summary Plan Descriptions (SPDs) control
- Reserve the right to amend or terminate any employee benefit
- Identify the appropriate department/person who will answer questions

Questions?

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