Morgan Lewis

HOT TOPICS IN EMPLOYEE BENEFITS

Steve Johnson, Dan Salemi, Julie Stapel, and Allison Fepelstein

January 20, 2022

Agenda

- Resolving Erroneous Payroll Tax and Reporting Penalties with the IRS
- No Surprises Act
- Variable Annuity Pension Plan (VAPP) Designs in the Multiemployer Space
- Thoughts on the Supreme Court Arguments in the *Hughes v. Northwestern University* Breach of Fiduciary Duty Case

Resolving Erroneous Payroll Tax and Reporting Penalties with the IRS

Morgan Lewis

IRC 6721 & 6722 Information Return Reporting Penalties

Returns Due	Penalty Rate	Not more than 30 days late	31 days late - August 1	After August 1	Intentional disregard**
From 01-01-2022 thru 12-31-2022* Rev. Proc. 2020-45	Per return / Max	$50 / $571,000	$110 / $1,713,000	$280 / $3,426,000	$570 / No max
From 01-01-2021 thru 12-31-2021* (Rev. Proc. 2019-44)	Per return / Max	$50 / $565,000	$110 / $1,696,000	$280 / $3,392,000	$560 / No max

Causes of the Issue

- COVID relief legislation created brand-new tax credits, payroll tax deferrals, and changes to employee fringe benefit exclusion standards
- The IRS was quick (but not quick enough) to modify, update, and publish new and existing employment tax–related forms and tax returns
- Tax return due date extensions hindered the annual rhythm of tax return processing
- IRS Service Centers went understaffed for months while IRS personnel worked remotely
- The backlog of unprocessed tax returns and taxpayer correspondence grew to unprecedented levels

Form 941 & Form W-2 Issues

- The evolution of the 2020 quarterly returns did not keep pace with legislative action, leading the IRS to process Forms 941 that at times were not in sync with applicable tax law
- 2020-Q4 and 2021-Q1 Forms 941 will include additional reporting of employer- and employee-shared Social Security tax deferrals that are due to be repaid
- CP256V Notices sent in October notified employers (often incorrectly) of employer-shared Social Security tax deferrals due to be repaid by the end of 2021
- Worries about misapplication of deferral repayments among calendar quarters
- Potentially harsh penalties, per PMTA 2021-07, "Penalty for Failure to Deposit Taxes Deferred Under CARES Act Section 2302(a)(2)"
- FFCRA Sick & Family Leave Wages W-2 reporting, per Notice 2021-53

Form 940 Issues

- Credits are applied against the federal unemployment taxes (FUTA) for state unemployment taxes (SUTA) that generally reduce the FUTA tax rate to 0.6% on the first $7,000 of wages (i.e., $42 per employee)
- IRS errors and delays in processing Forms 940 has led to tax underpayment and penalty demand letters, where SUTA taxes have not been properly credited for FUTA computational purposes
- Problems could increase in 2023 as available SUTA tax credits are set to reduce for states that have not repaid unemployment benefits loans to the federal government within two years
- Challenges with processing Forms 940 are likely to follow once SUTA tax credit rates become variable depending on the state

Form 1099-K Issues

- Effective January 1, 2022, payment settlement entities must issue Form 1099-K information returns to payees who receive $600 or more. (Prior to 2022, the reporting threshold was $20,000 or 200 payments.)
- This lower reporting threshold is expected to trigger new reporting obligations for hundreds of thousands (if not millions) of payees
- A glut of payee name–TIN mismatches is expected, which may lead to a substantial rise in penalty notices

* Penalties and related tax assessments can often be reduced (or even eliminated) by submitting proof that the incorrect information was provided by the payee-employee, and not due to a payor-employer mistake.

Form 3921 & Form 3922 Issues

- Per § IRC 6039(a), every corporation:

  (1) which in any calendar year transfers to any person a share of stock pursuant to such person's exercise of an incentive stock option, or

  (2) which in any calendar year records (or has by its agent recorded) a transfer of the legal title of a share of stock acquired by the transferor pursuant to his exercise of an option described in section 423(c) (relating to special rule where option price is between 85 percent and 100 percent of value of stock),

shall, for such calendar year, make a return at such time and in such manner, and setting forth such information, as the Secretary may by regulations prescribe.

- IRS Notice 972CG – for failure to report transaction details involving:
  - ISO exercises (required to be reported on Form 3921), and
  - ESPP stock transfers (required to be reported on Form 3922)
- Forms 3921 and 3922 must be issued to stock recipients by January 31
- Explaining to the IRS that the requisite information has been reported, albeit in a manner other than Form 3921 or Form 3922

No Surprises Act

Morgan Lewis

Overview

- The Consolidated Appropriations Act, 2021 (CAA) was signed into law on December 27, 2020
- Within the CAA was the No Surprises Act (Division BB, Title I)
  - Prohibits surprise medical billing from out-of-network (OON) providers, emergency service providers, and air ambulance providers
  - Includes other related "patient protections":
    - ID card requirements
    - External review for surprise medical bills
    - Advanced Explanation of Benefits (EOB)
    - Ensuring continuity of care
    - Provider directory requirements

What Is "Surprise Medical Billing"?

- "A surprise medical bill is an unexpected bill from a health care provider or facility that occurs when a covered person receives medical services from a provider or facility that, usually unknown to the participant, beneficiary, or enrollee, is a nonparticipating provider or facility with respect to the individual's coverage." 86 Fed. Reg. 36,872, 36,874 (July 13, 2021)
- Includes:
  - Balance-billed amounts (i.e., the difference between the actual amount billed by an OON provider/facility and the allowed amount the plan/issuer will pay)
  - OON cost-sharing (e.g., co-payments, co-insurance)
  - OON deductibles and out-of-pocket maximums
  - Additional fees and expenses charged by the OON provider/facility

No Surprises Act Guidance Thus Far: The Highlights

Issued July 13, 2021
Interim Final Rule: Requirements Related to Surprise Billing; Part I

Issued August 20, 2021
FAQs About Affordable Care Act and Consolidated Appropriation Act, 2021 Implementation Part 49

Issued September 16, 2021
Proposed Rule: Requirements Related to Air Ambulance Services, Agent and Broker Disclosures, and Provider Enforcement

Issued October 7, 2021
Interim Final Rule: Requirements Related to Surprise Billing; Part II

Issued December 30, 2021
FAB 2021-03: Group Health Plan Service Provider Disclosures Under ERISA Section 408(b)(2)

Interim Final Rule (IFR) Part I

- Prohibits surprise medical billing for all OON emergency services, air ambulance services, and certain OON services provided at in-network facilities
- Applies to group health plans and issuers, including self-insured group health plans and grandfathered plans
  - Does not apply to excepted benefit plans, retiree-only plans, account-based plans (e.g., HRAs) or short-term, limited-duration insurance
- Amends the Employee Retirement Income Security Act (ERISA), the Public Health Service Act (PHSA), and the Internal Revenue Code (Code)
  - Additional conforming PHSA provisions for providers
  - Special related amendments under the Code related to HDHP/HSAs
- Generally effective January 1, 2022
  - For certain provisions, "good-faith compliance" until more formal guidance is released

IFR Part II

- Establishes the requirements for certified IDR entities to resolve billing disputes, provides that the QPA is the presumed OON rate, and expands external review to apply to surprise billing
- Requires that certain providers and facilities provide a good-faith estimate of the charges to uninsured (or self-pay) individuals so they can know what costs to expect when seeking healthcare
- Effective January 1, 2022

Group Health Plan Disclosure Requirement

- The No Surprises Act requires plans and issuers to make publicly available, post on a public website of the plan or issuer, and include on each EOB for an item or service with respect to which the No Surprises Act protections apply information in plain language on:
  - the restrictions on balance billing in certain circumstances,
  - any applicable state law protections against balance billing,
  - the requirements under Code Section 9816, ERISA Section 716, and PHSA Section 2799A-1, and
  - information on contacting appropriate state and federal agencies in the case that an individual believes that a provider or facility has violated the restrictions against balance billing
- The DOL has provided a model notice that plans may use to satisfy this requirement
  - available at surprise-billing-model-notice.docx (live.com)
- CMS supplied specific contact information that should be incorporated into the DOL model:
  - Website: https://www.cms.gov/nosurprises/consumers
  - Phone number for information and complaints: 1-800-985-3059

Tri-Agency FAQs – Part 49

- Addresses enforcement of the following No Surprises Act requirements:
  - Advanced EOBs
  - ID card requirements
  - Updated provider directories
  - Continuity of care
- Since regulations interpreting the continuity-of-care requirements will not be issued before January 1, 2022 (i.e., the statutory effective date), plans are to use a good-faith, reasonable interpretation of the statutory language in implementing the above requirements, pending the issuance of further guidance.

Broker Disclosure Requirements

- The CAA amended ERISA Section 408(b)(2) to require certain covered service providers of group health plans expecting to receive $1,000 or more in direct or indirect compensation to disclose specific information to a plan fiduciary about their expected direct and indirect compensation in connection with providing those services
  - Effective for contracts entered into or renewed on/after December 27, 2021
- FAB 2021-03 announced a temporary enforcement policy for group health plan service provider disclosures under ERISA Section 408(b)(2)(B)
  - Pending future guidance, covered service providers and plan fiduciaries are expected to implement the ERISA Section 408(b)(2) requirements using a good-faith, reasonable interpretation of the law
    - The DOL will view covered service providers looking to prior DOL guidance developed for pension plans under ERISA Section 408(b)(2) as "good faith"
    - The DOL does not believe separate regs are needed at this time

Variable Annuity Pension Plan (VAPP) Designs in the Multiemployer Space

Morgan Lewis

What Is a Variable Annuity Pension Plan?

- A traditional defined benefit (DB) plan under which participants earn the right to an annuity benefit at retirement, with an important twist:
  - Benefit accruals and annuity payments fluctuate (increase or decrease) each year based on the plan's investment return compared to a preset investment "hurdle rate" (typically between 4%-6%), thus eliminating the impact of adverse investment experience in plan funding and withdrawal liability calculations
  - Other actuarial risks (mortality, turnover, etc.) are managed through a small (typically 2%-3%) contribution surplus
  - If designed appropriately, a VAPP virtually eliminates future withdrawal liability
- VAPP structure has been permitted by the IRS since the 1950s
- However, they were not commonly used until the 2014 regulations provided additional flexibility to design VAPPs in a way that could insulate participants from severely negative investment returns

How VAPPs Work

- Like a traditional DB plan, a participant's benefit accruals are calculated based on a formula
- Unlike a traditional DB plan, a participant's accrued benefit is adjusted in future years based on the VAPP's investment returns (ROR) relative to an established "hurdle rate" of return
  - The hurdle rate (ordinarily approx. 5%) is specified in the plan
  - If ROR = hurdle rate, accrued benefit does not change
  - if ROR > hurdle rate, accrued benefit increases by overage
  - if ROR < hurdle rate, accrued benefit decreases by underage
- Higher hurdle rates provide less inflation protection but reduce the cost of providing the VAPP accrual

Basic VAPP Example

- Participant earns an accrued benefit for each year of service equal to $100 per month
- Plan's VAPP hurdle rate is 5%
- In Year 1, Plan has ROR of 5%
  - Monthly benefit is unchanged at $100 per month ($100 x (1.05 / 1.05))
- In Year 2, Plan has ROR of 15%
  - Monthly benefit increases to $109.52 ($100 x (1.15 / 1.05))
- In Year 3, Plan has ROR of -10%
  - Monthly benefit decreases to $93.87 ($109.52 x (.9 / 1.05))

Benefits and Risks of VAPPs

- All VAPP participants (including retirees) are exposed to the market to some extent (this can be mitigated through the "cap & shore" variation discussed below)
- The employer is protected from investment risk and the participant enjoys the upside of expected long-term positive investment returns
- Basic VAPP should not generate withdrawal liability because the benefit is fully funded when accrued (the investment returns are "baked in")

Options to Address VAPP Risks

- Volatility can be mitigated by plan design, as well as investment strategy
- For example, a plan could be designed to have some traditional DB accruals and some VAPP accruals
- Investment risk can be mitigated by conservative investments, but conservative investments limit the growth potential for the participant's benefit
- Alternatively, the VAPP could lock in a participant's benefit at retirement or establish a floor benefit (e.g., minimum accrued benefit per year of service)
- A common alternative VAPP design is referred to as a "cap & shore" (C&S) design. This design limits the impact of extreme investment returns (gains and losses) on accrued benefits

Cap & Shore VAPP Example

Participant has an accrued benefit equal to $100 per month. Plan's hurdle rate is 5%. Plan "caps" return at 10% and "shores up" returns to 2%.

In Year 1, Plan has ROR of 5%
Monthly benefit is unchanged at $100 per month ($100 x (1.05 / 1.05))

In Year 2, Plan has ROR of 15%
Monthly benefit increases to $104.76 ($100 x (1.10 / 1.05))

In Year 3, Plan has ROR of -10%
Monthly benefit decreases to $101.76 ($104.76 x (1.02 / 1.05))

Cap & Shore VAPP Discussion

- The C&S VAPP has less volatility (and less upside/downside) relative to the Basic VAPP design
- There are variations of the C&S VAPP design that provide additional upside to participants
- C&S VAPPs often use a "stabilization reserve" to fund the shoring up of annual returns
  - The stabilization reserve can be funded through contributions and/or market returns in excess of the cap
  - If the stabilization reserve is exhausted, future accrued benefits may not be shored up
  - If an unreasonable amount is in the stabilization reserve, future contributions may be reduced and benefits may be increased

Where VAPPs Are Most Commonly Implemented

- Existing multiemployer DB plans are structuring future benefit accruals (some or all) as VAPP accruals
  - This typically requires the legacy DB portion of the plan to be very well (i.e., fully) funded, otherwise the employer contribution will not be sufficient to fund the legacy DB portion of the plan while also providing a meaningful future VAPP accrual
  - PBGC has raised issues with setting up a new, separate VAPP where the contributing employers remain in the legacy DB plan, making it somewhat challenging to set up a new plan if the employers have not withdrawn from (and paid withdrawal liability to) the legacy DB plan
- Other employers are withdrawing from multiemployer DB plans and establishing new VAPPs as a replacement benefit
  - This may require the payment of withdrawal liability today, but it helps avoid future underfunding/growth in future unfunded vested benefits

Supreme Court Arguments in the *Hughes v. Northwestern University* Case

Morgan Lewis

Hughes v. Northwestern University

- On December 6, 2021, the US Supreme Court heard oral arguments in *Hughes v. Northwestern University*.
- One of the numerous cases filed against private universities over the last several years alleging breach of fiduciary duty based on the fees and performance of the investment options offered under participant-directed defined contribution plans (such as 401(k) plans).
- The Northern District of Illinois found no breach, noting that the investment lineup was large enough that participants could avoid overpriced or underperforming options by choosing other options.
- The Court of Appeals for the Seventh Circuit affirmed.
- The Supreme Court agreed with the petitioners (plaintiffs) to hear the case.

Hughes v. Northwestern University

Background on Fee and Expense Litigation

- The prior two years have seen an explosion of fee and expense litigation with nearly 200 cases filed in 2020 and 2021.
- According to the US Chamber of Commerce, ERISA claims increased five fold from 2019 to 2020.
- Specific claims vary among the complaints, but include the following:
  - failing to understand, bargain for, obtain, etc., "revenue sharing"
  - offering mutual funds instead of CITs or separate accounts
  - offering retail instead of institutional share class funds
  - offering "too many" investment options
  - failure to disclose fees and revenue sharing

Hughes v. Northwestern University

Allegations in Hughes v. Northwestern University

- Too Many Recordkeepers. As with many of the cases filed against private universities, one allegation is that it was imprudent for Northwestern to have multiple recordkeepers (Northwestern had two).
  - The argument is that using multiple recordkeepers leads to excessive recordkeeper fees, including by forgoing the opportunity to effectively leverage the large size of the plans.
  - Plaintiffs also pointed to other private universities that consolidated recordkeepers prior to the wave of litigation.
  - While the wave of litigation has certainly shined a light on it, multiple recordkeepers are not at all uncommon in the 403(b) plan market.
- Too Many Retail Share Classes. The second major claim in the *Hughes* case is that the Northwestern plan fiduciaries failed to obtain the lowest share class to which the plans would be entitled based on their size.

Thoughts on *Hughes v. Northwestern University*

Highlights of Supreme Court Argument

- Three lawyers presented arguments—counsel for the petitioners (plaintiffs), counsel for the DOL (amicus), and counsel for the respondents (the Northwestern fiduciaries).
- Justice Amy Coney Barrett recused herself as she was on the Seventh Circuit Court of Appeals when the case was heard there.
- Each of the remaining eight Justices asked at least one question, with Justices Breyer and Sotomayor and Chief Justice Roberts questioning the most actively.

Thoughts on *Hughes v. Northwestern University*

Highlights of Supreme Court Argument

- The applicable pleading standard
  - Can you survive a motion to dismiss simply by alleging that a lower fee was available and the fiduciary didn't ask for it?
  - If so, will that subject fiduciaries to an influx of nuisance lawsuits, increasing the cost of fiduciary liability insurance and potentially discouraging the offering 401(k) plans?
  - Court seemed to be struggling with the balance of these considerations.
  - Questions from Justice Kavanaugh correctly noted that the motion to dismiss is critical in the ERISA fee and expense litigation.
    - Failure to get a motion to dismiss frequently leads to settlement to avoid expensive discovery.

Thoughts on *Hughes v. Northwestern University*

Highlights of Supreme Court Argument

- General skepticism of the "large menu defense" (phrase used by Justice Thomas in a question) on the share class issue
  - Debate over whether Seventh Circuit's opinion really means that as long as there are "good" investment options among the "bad" investment options, a fiduciary should not face liability
- Characterization of institutional and retail share classes
  - Justices Breyer and Sotomayor focused on the retail and institutional share classes being "identical" other than fee
  - That's not necessarily the case as institutional share classes often do not include a mechanism for paying administrative expenses

Thoughts on *Hughes v. Northwestern University*

- Less traction on claims regarding multiple recordkeepers
  - Skepticism that multiple recordkeepers alone are sufficient to state a fiduciary breach claim
  - Participant-focused reasons for why there may be more than one recordkeeper such as employee preference

What's Next?

A decision in the case could come at any time from now until late June when the court leaves after the end of the term.

If we can read anything from the questions, they appeared to break down on party lines with the more conservative Justices seeming to ask questions more sympathetic to the Northwestern fiduciaries and the liberal justices (particularly Breyer and Sotomayor) asking questions more sympathetic to the petitioners. **But there's really no way to tell.**

Given the large number of pending fee and expense cases, the impact of the decision could be significant.

Questions?

Biography

Steven P. Johnson
Washington, D.C.
+1.202.739.5741
steven.johnson@morganlewis.com

With experience gained as a trial lawyer in the Tax Division of the US Department of Justice (DOJ), **Steve** advises clients on tax controversies and litigation matters involving complex tax issues. Before joining Morgan Lewis and working for the DOJ, Steven served as a law clerk to Judge Tucker L. Melancon of the US District Court for the Western District of Louisiana. He holds a Masters in Tax Law (LL.M.) from Georgetown Law School.

Biography

Daniel R. Salemi
Chicago
+1.312.324.1704
dan.salemi@morganlewis.com

Dan counsels clients on the full range of issues related to retirement plans, health and welfare plans, plan investments (under ERISA and individual US state laws), and deferred and equity-based compensation arrangements, helping them design and maintain state-of-the-art benefit plans to achieve unique operational goals. Dan's broad experience in the employee benefits area includes the representation of clients in collective bargaining, litigation, and mergers and acquisitions.

Biography

Julie K. Stapel
Chicago
+1.312.324.1113
julie.stapel@morganlewis.com

Julie provides effective and practical solutions to clients' complex ERISA issues. She proficiently steers plan sponsors and investment managers through ERISA's fiduciary and prohibited transaction rules, and negotiates virtually every type of investment-related agreement with employee benefit plans. Julie uses exceptional communication and interpersonal skills to advise clients on a wide range of ERISA topics, including effective fiduciary governance, risk management, the creation of "white label" investment options, and the application of environmental, social, and governance (ESG) factors in plan investment decisionmaking.

Biography

Allison J. Fepelstein
Washington, D.C.
+1.202.739.5667
allison.fepelstein@morganlewis.com

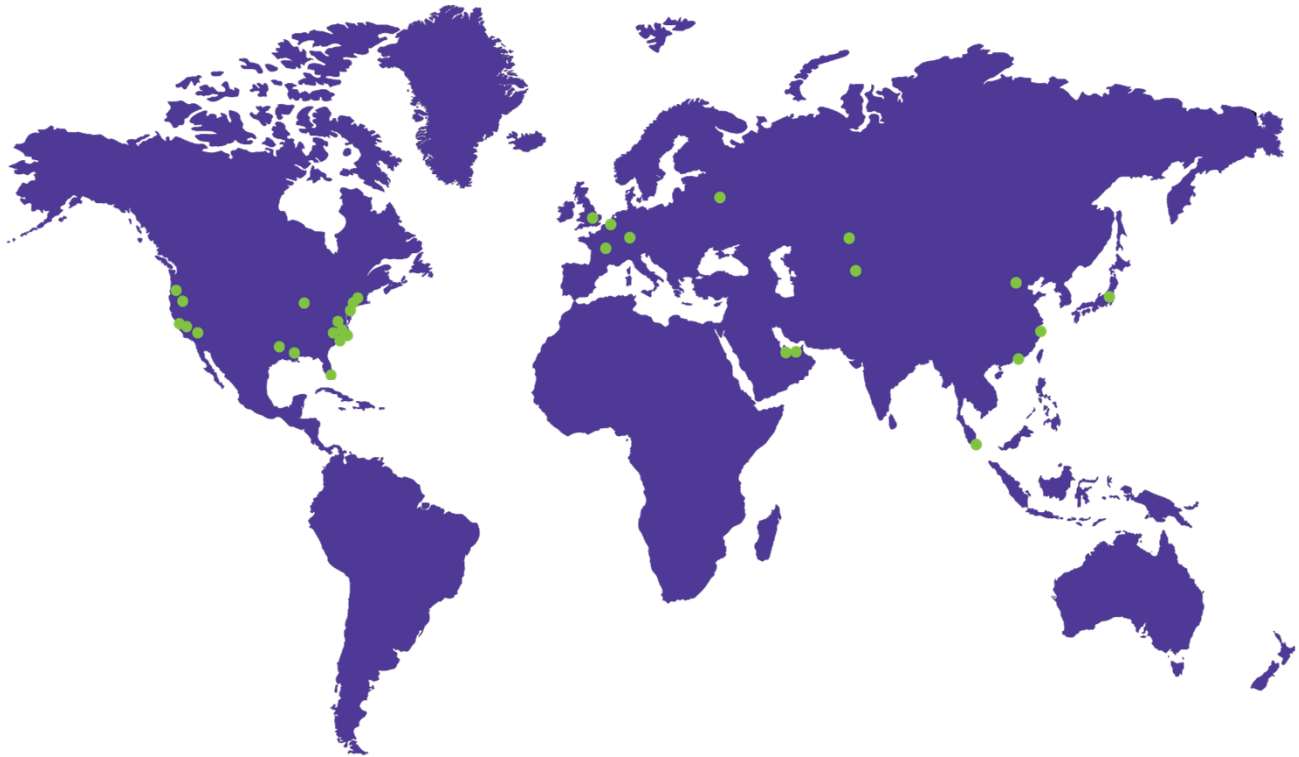
Allison advises clients on health and welfare plans, helping them stay in compliance with applicable requirements under ERISA, the Internal Revenue Code, the Affordable Care Act, COBRA, and HIPAA. She also prepares and reviews plan documents and related materials. In addition, Allison reviews and negotiates services agreements with third parties. Before joining Morgan Lewis, Allison served in the US Department of Labor's (DOL) Office of Health Plan Standards and Compliance Assistance. There she helped develop and issue regulatory, interpretive, and compliance-assistance guidance concerning group health plans under ERISA.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



Morgan Lewis

THANK YOU