

# EMPLOYMENT, LABOR & BENEFITS Quarterly

Foster Swift Employment, Labor & Benefits Group

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## There's Still Time to Avoid Tax Penalties on Non-Compliant Deferred Compensation Arrangements by Correcting During 2010

by: [Joel C. Farrar](#)

Nonqualified deferred compensation arrangements were required to comply, in writing, with the highly technical rules of Internal Revenue Code Section 409A ("Section 409A") effective as of January 1, 2009. A "deferred compensation arrangement" is any arrangement with an employee or independent contractor that could result in compensation being paid in a year following the year in which the compensation is earned. Thus, the term may include traditional deferred compensation plans, as well as employment agreements, independent contractor agreements, bonus arrangements, severance plans, stock incentive plans and management service contracts.

Failure to comply with the rules of Section 409A could result in the employee having to recognize all amounts "deferred" under the arrangement as current income, plus interest and a 20% penalty. The employer

could also be subject to penalties and interest for not withholding sufficient income and employment taxes.

The IRS has published guidance that permits an employer to correct a Section 409A failure in the document that sets forth the terms of the arrangement. Corrections made before January 1, 2011 may avoid significant penalties. Beginning on January 1, 2011, the correction procedure will continue to be available but penalties may apply.

We recommend that all employers have their deferred compensation arrangements, including employment agreements, independent contractor agreements, bonus arrangements, etc., reviewed for compliance with Section 409A before the end of 2010, so that any errors might qualify for penalty-free correction.

## New 2011 W-2 Reporting Requirements

by: [Timothy P. Burkhard](#)

A section of the Patient Protection and Affordable Care Act (PPACA) makes some major changes in Form W-2 reporting that will impact employers in the near future. PPACA requires that an employer calculate and report the "aggregate cost" of all employer-sponsored

health coverage to an employee on the employee's W-2 form. This new "informational" reporting requirement applies with the 2011 tax year. This means that for most employers, the first W-2 forms that are distributed with this

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new information will be distributed in January of 2012. However, because an employee whose employment is terminated before the close of a calendar year may request an early W-2 form from his or her former employer (which must be provided by the employer within 30 days of the request) employers must be prepared for and implement the new reporting requirements at the start of 2011. Employers will also need to ensure that their payroll systems are updated to reflect these changes so that they will be able to provide W-2 forms that comply with the new requirements.

One of the major unanswered questions is how to determine the aggregate cost of employer-sponsored health coverage. Although the new regulation indicates that employers should use rules similar to the COBRA valuation

rules to determine the coverage's aggregate cost, the exact formula for determining the aggregate cost of coverage has not been finalized. Reportedly, government regulations regarding how to value plans are imminent and any such regulations would presumably apply both to COBRA and the new W-2 reporting requirements. Another challenge for employers is that some of the plans covered by the new reporting requirement are not plans that previously would have been valued for COBRA purposes, such as an on-site medical clinic. Employers will now be required to determine reportable values for such programs.

Because the changes implemented by this section go into effect beginning January 1, 2011, employers should prepare for these changes now so that they will be able to comply with the new regulations in 2011.

## IRS Guidance States Certain Donated Paid Time Off is Taxable

by: [Lauren B. Dunn](#)

The IRS recently issued guidance regarding whether paid time off ("PTO") credits donated under an employer-sponsored leave-sharing program are taxable to the donor employee if the donation is made by waiving the PTO credits before the PTO is earned. The guidance states that in this situation, the donor employee would not be able to avoid taxation because the donation would be an anticipatory assignment of income and therefore, taxable income to the donor employee.

The guidance, however, does state that donor employees could avoid tax on their donations if their employer-sponsored leave-sharing program complied with the current IRS guidelines permitting PTO donations for

medical emergencies of other employees. A medical emergency is one that requires an employee's prolonged absence from work, resulting in a substantial loss of income because the employee has exhausted all of his otherwise available paid leave. Employees donating PTO credits under a medical emergency leave-sharing plan would be permitted to designate the recipient employee, without being taxed on the donation.

Nontaxable donations are also available under an IRS approved "major disaster" leave-sharing plan. In that case, an employee donating PTO credits under a "major disaster" leave-sharing plan would not be permitted to designate specific recipients of the donated leave.

## The Role of an ERISA Expense Account in Paying Plan Expenses

by: [Stephen I. Jurmu](#)

**A. BACKGROUND.** Each participant in a retirement plan is often given the opportunity to invest his or her plan account balance in various investment vehicles. Each investment vehicle is managed by a "Fund Manager" who is paid a management fee (the "Fee"). That Fee

is typically computed as a percentage (for example, 80 basis points) of the assets under management. This Fee will typically be taken from the investment return that would otherwise have been credited to each participant's plan account (for example, the

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**A.** investment return that is credited when using an 80 basis point Fee will be 7.2% rather than the actual 8.0% rate of return). Sometimes the Fee is deducted directly from the participant's account. As the market value of plan assets grows, its fiduciaries may conclude that the sheer size of its assets under management will produce a Fee that exceeds any reasonable amount of Fund Manager compensation. In that circumstance, the plan fiduciaries sometimes conclude that they have a duty to negotiate a lower Fee. Any Fee savings that the fiduciary negotiates is typically applied in one of the ways that is discussed in subparagraphs 1. and 2. below.

**1. IMPROVING THE RATE OF RETURN.** The fiduciary may negotiate a Fee reduction that improves the rate of return on the investment. For example, an 80 basis point Fee could be reduced to 60 basis points. In that case, an 8.0% return on assets would result in a 7.4% return to the participant's account. 60 basis points would be paid to the Fund Manager as its Fee.

**2. FUNDING THE ERISA EXPENSE ACCOUNT.** The fiduciary may negotiate a Fee reduction that creates revenue for use in an ERISA Expense Account. For example, an 80 basis point Fee could be reduced to 60 basis points. In that case, an 8.0% return on assets would result in a 7.2% return to the participant's account. 60 basis points would be paid to the Fund Manager as its Fee, and 20 basis points would be credited to the ERISA Expense Account.

**B. PURPOSE OF ERISA EXPENSE ACCOUNT.** The purpose of an ERISA Expense Account is to use its assets to pay plan-related expenses that can properly

be paid from plan assets (for example, certain legal, accounting, and record keeping fees). ERISA Expense Account assets are, in the case of a plan that is subject to ERISA, treated as plan assets and are subject to ERISA's fiduciary standards.

**C. MAINTAINING THE ACCOUNT.** The ERISA Expense Account can be maintained in either of the two ways that are described below.

**1. INSIDE THE PLAN.** When the ERISA Expense Account is held inside the plan, the excess revenues are placed in an allocated account within the Plan. The funds held in the allocated account may be used to pay plan expenses during the plan year. However, any funds remaining in the allocated account at the end of the plan year must be allocated to the plan accounts of plan participants. The method of allocating excess revenue among plan participants' plan accounts can be either pro rata based on the size of the participants' respective account balances, or per capita in identical amounts.

**2. BY THE RECORD KEEPER.** The record keeper may retain the excess revenues as a credit that the plan may utilize to pay plan expenses at any time. The money is not deposited into a plan account since it is retained by the record keeper for the benefit of plan participants. As a result, the credit may be carried forward from year to year without any requirement that the excess be allocated to participants' plan accounts.

Please let us know if you would like to discuss the use of an ERISA Expense Account.

## Sixth Circuit Prevents Plan Administrator From Correcting Benefit Calculation

by: [Stephen J. Lowney](#) & [Lauren B. Dunn](#)

The Sixth Circuit recently broke precedent and joined a number of other U.S. circuit courts by preventing an ERISA plan administrator from correcting an inaccurate benefit calculation. In a recent pension benefit case, the Sixth Circuit recognized equitable estoppel, and prevented a plan administrator from correcting a previously calculated benefit amount when that benefit was represented by a

writing and extraordinary circumstances existed which in equity greatly favored the plan participant. This is an especially important development for Michigan plan administrators since Michigan sits within the purview of the Sixth Circuit.

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In *Bloemker*, the plan participant had, by January 2005, participated in his employer's pension plan for almost thirty years. The participant, with plans to retire, contacted the plan administrator to get a calculation of his benefits under the plan. He received an election form from the plan administration stating that if he elected benefits in the form of a joint and survivor annuity with his spouse, he would receive \$2,339.47 per month, and his spouse would receive \$1,169.75 per month after his death.

The participant elected the joint and survivor annuity benefit and received benefit payments in the amount promised until September 2006. At that time, the plan administrator notified the participant that his benefit calculation was incorrect, and that he was only entitled to \$1,829.71 per month, a difference of \$509.78. The plan requested that the participant form a plan to repay the amount he was overpaid, and after exhausting all administrative remedies, the participant filed suit based on an equitable estoppel theory.

The Sixth Circuit ruled in favor of the participant, remanding the case back to the district court for further findings consistent with its decision. Traditionally, the Sixth Circuit Court of Appeals voiced concern with recognizing equitable estoppel in pension benefit cases because to allow such claims and dealings between plan officials and participants would enable the alteration of plan terms. However, the Sixth Circuit broke from this concern, opining that these reasons were not enough to defeat claims of equitable estoppel where benefit representations were made to the plan participant in writing and extraordinary circumstances existed under which the equities significantly favored the participant. The Sixth Circuit also reasoned that in addition to a writing and extraordinary circumstances, the plan formula cannot allow for participants to calculate benefits themselves and that traditional requirements, such as proof of gross negligence, must also be satisfied.

## Employer's "Honest Belief" Defeats Military Reservists' USERRA Claim

by: **Michael R. Blum**

The Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA") applies to all public and private employers in the United States, regardless of size. This would include employers with only one employee, as well as states and their political subdivisions, such as counties, parishes, cities, towns and townships, villages and school districts.

USERRA provides two types of protections to employees. First, employees are protected against discrimination based on military affiliation or retaliation for pursuing rights available under the act. Employees are also provided job protection and return-to-work rights when they take a leave of absence from employment to perform military duty.

Employee protections under USERRA are quite considerable. They are not, however, absolute. In *Escher v. BWXT*, decided by the Sixth Circuit Court of Appeals on August 18, 2010, the court addressed the conflict between

an employer's enforcement of policies prohibiting use of company computer equipment for non-work activities, and employee rights under USERRA. Escher was an engineering specialist who had worked for BWXT, a civilian technology firm. Escher also held leadership positions in the Navy Reserve, with BWXT's knowledge.

In 2004, BWXT changed its military leave policy, stopping a practice of allowing employees to take a partial week of unpaid military leave after exhausting their allotted 80 hours of military leave pay. Escher complained to a payroll employee in 2004 about the change and repeated his complaint to a senior human resources specialist in the summer of 2005.

In August 2005, BWXT received an anonymous complaint that Escher was using company time for his reserve work, the second such complaint the company received concerning Escher's work for the Naval Reserves. Investigation of the first complaint found no irregularity

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in Escher's Internet usage. However, investigation of the second complaint showed irregular e-mail use, and indicated that Escher was doing personal, Naval Reserve business while at BWXT. As a result, BWXT placed Escher on administrative leave to investigate the matter further, and terminated him on September 22, 2005.

Escher sued in U.S. District Court, alleging that his discharge was retaliatory for having complained about the change in the military leave policy in violation of USERRA and state law, but the trial court dismissed the case. On appeal, the Sixth Circuit Court of Appeals upheld the dismissal, finding no evidence of retaliation.

The Sixth Circuit began its analysis with an acknowledgement that the retaliation provision of USERRA prohibits an employer from discriminating in employment or taking adverse employment action against an individual who exercises rights provided for under USERRA. The court, citing prior Sixth Circuit precedent, also acknowledged that discriminatory motive under USERRA can be inferred from a number of circumstances, including (1) proximity in time between an employee's military activity and an adverse action, (2) inconsistencies between the proffered reason and other actions of the employer, (3) an employer's expressed hostility towards members protected by USERRA, and (4) disparate treatment of similarly situated employees.

Among other claims summarily rejected by the court, Escher argued that his discharge followed closely after he registering his second complaint about the company's military leave policy, thereby creating an inference of retaliation. To rebut such inference, it was necessary for BWXT to show that it would have terminated Escher anyway, for a valid reason. Upon review of the evidence, the court determined that the decision to terminate Escher's employment was made in response to an anonymous complaint, so the temporal proximity between the investigation of Escher's e-mail use and his complaints about military leave was insufficient to show discriminatory motivation.

The court also found that Escher failed to show any disparate treatment by the company or evidence that the stated reason for Escher's discharge was a pretext for unlawful retaliation. As both the district court and the Sixth Circuit noted, Escher's argument basically was that BWXT's reasons for firing him were a pretext for

discriminating against him based upon his complaints. In the Sixth Circuit, which covers Michigan, the court has adopted in discrimination cases a "modified honest belief" rule, which states that "for an employer to avoid a finding that its claimed nondiscriminatory reason was pretextual, the employer must be able to establish its reasonable reliance on the particularized facts that were before it at the time the decision was made." In other words, when faced with a claim of pretext, the employer must be able to show that it made its decision based on an honestly held belief that a nondiscriminatory reason supported by specific facts after a thorough investigation warranted the action taken.

Since the Sixth Circuit determined that BWXT made its decision to terminate Escher's employment based on an honestly held belief, supported by facts discovered through a reasonably thorough investigation that he was doing work for his job in the Naval Reserves during company time, not because of complaints protected under USERRA, the court dismissed the case. This case demonstrates how thorough investigations and development of particularized facts prior to taking an adverse employment action can provide a defense to, or possible even avoid, lawsuits, even if the involved employee has engaged in protected activity.

### 2011 Best Lawyers in America® Announced

Thirty-six Foster Swift attorneys were recognized.

**Employment, Labor & Benefits** attorneys selected:

- **Melissa J. Jackson** - *Labor & Employment Law*
- **Stephen I. Jurmu** - *Employee Benefits Law; Corporate Governance & Compliance Law; Corporate Law*
- **Stephen J. Lowney** - *Employee Benefits Law*
- **Sherry A. Stein** - *Employee Benefits Law*

### 2010 U.S. News - Best Lawyers "Best Law Firms" Rankings Announced

Foster Swift was selected in 38 categories, including:

#### Lansing Tier 1

- Alternative Dispute Resolution
- Employee Benefits (ERISA) Law
- Health Care Law
- Workers' Compensation Law - Employers

#### Detroit Tier 3

- Labor Law - Management

## H-1B VISA REMAINS AVAILABLE! The U.S.'s "Greatest" Utility Business Visa, Typically Oversubscribed and the Subject of Scarcity, Remains Available

by: [Ryan E. Lamb](#) & [Samuel J. Frederick](#) □

For employers interested in hiring a foreign worker for a "specialty occupation" (typically, a job that requires at least a Bachelor's degree or its functional equivalent), an H-1B Employment Visa is an option with a number of very attractive features: (i) *duration* – H-1B's are issued for an initial term of 3 years, with the option of a 3 year extension; (ii) *dual intent* – the visa holder can have a temporary intent or a permanent intent to reside in the U.S.; this allows the visa holder to pursue permanent residency, if desired, without leaving the U.S. and without violating his or her temporary visa status; (iii) *change of status* – an H-1B can often be obtained in the U.S. without traveling to a foreign consulate to acquire the new visa and seek re-entry to the U.S.; and (iv) *portability* – in the event of a change in employment, an H-1B can be transferred to a different employer.

In recent years, a major hurdle has negatively affected the H-1B's effectiveness – the need to win the "lottery" in order to obtain a visa.

As with many U.S. Visas, H-1Bs are subject to a quota system for availability. Currently, only 65,000 "regular" or "cap subject" H-1B Visas are available annually. There are also modified-cap or cap-exempt categories limited to certain applicants. H-1B Visas subject to the cap have starting dates at the beginning of the "fiscal year," that runs from October 1 to September 30 each year. This means that one could not apply for an H-1B for fiscal year 2011

(Oct. 1, 2010 – Sep. 30, 2011) until April 1, 2010, with an employment starting date of October 1, 2010.

Until 2009, recent filing years had experienced more than 120,000 applications for H-1B Visas filed on the first day of filing availability (April 1 each year – although the "April Fool's Day" irony did not become apparent until the exhaustion of the cap became routine). All applications filed on April 1 (when the cap is met on the 1st day of filing) were literally placed in a random lottery drawing for the 65,000 visas available. Thus, filing an application for an H-1B Visa on April 1 (no sooner, no later) provided applicants with a roughly 50% chance of pursuing a visa. Losers of the lottery were out of luck and out their filing fees.

Recently, however, with the slowed economy, the cap has not been reached as quickly as in the past. Last year, the cap was not reached until December 21, 2009. Currently, as of the last cap count dated July 16, 2010, **39,700 visas remain available. However, this can change quickly, depending upon national hiring and filing activity.**

For years dynamic and growing companies have been frustrated by the cap's impact on their ability to hire the best and the brightest talents to meet their needs. As economic activity ramps up, you may wish to apply for a Visa before they run out.

## New Rules Under PPACA Governing the Rescission of Health Care Coverage

by: [Johanna M. Novak](#) □

Thousands of Americans lose health care coverage each year due to rescissions. According to the House Energy and Commerce Committee, some health insurance companies wait until expensive claims are submitted and then investigate enrollment materials to try to locate some discrepancy or omission in those materials that

could justify a rescission of coverage and denial of the expensive claims, even if the discrepancy or omission was unintentional and unrelated to the medical condition for which the patient sought care.

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To end this practice, the Patient Protection and Affordable Care Act (“PPACA”) included language to ensure that individuals would no longer unjustly lose health coverage by rescission. Effective for the first plan year beginning on or after September 23, 2010, a group health plan or health insurance issuer cannot rescind coverage with respect to an individual once the individual is covered under a plan or policy unless the individual performs an act, practice, or omission that constitutes fraud or an intentional misrepresentation of material fact, as prohibited by the terms of the plan or coverage. A group health plan or health insurance issuer must provide at least 30 days advance written notice to each participant who would be affected before coverage can be rescinded, regardless of whether the coverage is self-funded or fully-insured. These regulations apply to both grandfathered and non-grandfathered health plans.

The regulations define a rescission as a cancellation or discontinuance of coverage that has a retroactive effect. For example, a cancellation that treats a policy as void from the time of the individual’s or group’s enrollment is a rescission. A cancellation is not a rescission if: (1) the cancellation has only a prospective effect, or (2) the cancellation is effective retroactively to the extent that it is attributable to a failure to timely pay required premiums or contributions towards the cost of coverage.

The regulations contain the following example: An employer sponsors a group health plan that provides

coverage for full-time employees. Judy has coverage under the plan because she is a full-time employee. Judy is later transferred to part-time position. The plan mistakenly continues to provide health coverage to Judy, and collects premiums from her and pays claims that she submitted. The plan soon discovers that Judy is not eligible for benefits because she is not a full-time employee and would like to rescind her coverage effective as of the date that Judy changed from a full-time employee to a part-time employee. However, under the new regulations, the plan cannot rescind Judy’s coverage because there was no fraud or intentional misrepresentation of material fact. The plan may cancel Judy’s coverage prospectively only. This example demonstrates that employers must be vigilant in their plan administrative activities (including immediately informing the insurer) and in terminating coverage immediately when an employee loses eligibility, for example, when the employee separates from service. A retroactive termination for administrative reasons will no longer be permitted, absent some fraud or intentional misrepresentation of material fact.

In addition, a rescission is permitted because of fraud or intentional misrepresentation of material fact only if the plan or policy actually prohibits fraud or intentional misrepresentation of material fact. We therefore recommend that employers determine whether their plan documents or insurance policies contain this important language.

## Transfer During Pregnancy Raises Bias Claims, Sixth Circuit Rules

by: [Rebecca S. Davies](#)

The Sixth Circuit Court of Appeals, the federal appeals court that governs Michigan, recently addressed the ability to transfer a pregnant employee to a light duty position without the transfer constituting an adverse employment action. The case addressed the legality of the transfer and ultimate termination of a female welder under the ADA, Title VII and state statutory protections. The federal appellate court held that a female welder at a boat repair facility who was involuntarily transferred after becoming pregnant may pursue pregnancy and disability discrimination claims regarding the transfer, but

has no bias claim regarding her termination after a doctor ordered bed rest for the remainder of her pregnancy.

In analyzing the transfer issue, the court recognized that welding work at that company was physically demanding, it required “heavy lifting, climbing up ladders and stairs, maneuvering into barge tanks, and, occasionally, the overhead handling of equipment.” In addition, “welders were exposed to fumes, dust, and organic vapors in the course of their work.”

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In this case, the employee was transferred from her position as a welder to the tool room on the night shift. The appellate court recognized that the employee received the same salary, experienced no loss in benefits, and had in some ways better working conditions in the tool room. Although the trial court found the transfer from a welder job to a tool room was not an adverse employment action, the Sixth Circuit said a reasonable jury could find adverse action in that the employee, a single mother, was transferred to the night shift in a job requiring less skill, even though her pay remained the same. “[T]he evidence is sufficient to raise a genuine issue of material fact as to whether management, rather than undertaking an objective evaluation to determine whether the employee could perform her welding job while pregnant, instead subjectively viewed the employee’s pregnancy as rendering her unable to weld.” Further, the appellate court found that the plaintiff raised a triable ADA claim based on the theory that her supervisor regarded her

as substantially limited in working a class of jobs (welding) because of her past history of miscarriage.

This decision demonstrates the broad standard of what constitutes an “adverse employment action” and underscores the importance of employers not assuming or speculating as to an employee’s abilities or inabilities. Instead, employers are obligated to engage in a dialogue with an employee as to his/her ability to perform the essential functions of the job, with or without accommodation, and utilize the opinions and recommendations of healthcare providers where appropriate. There is no one-size-fits-all answer with respect to disability issues. Employers are to avoid making decisions based upon preconceived notions or stereotypes. Instead, employers should engage in the interactive process with the employee and, where appropriate, seek input from legal counsel before an employment decision is made, not after.

**For more information about labor and employment or employee benefits law related issues, please contact a member of the Foster Swift Employment, Labor & Benefits Group.**

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