



EMPLOYEE BENEFITS CLIENT ALERT

EMPLOYERS MUST CONSIDER EMPLOYEE BENEFITS IMPLICATIONS WHEN REDUCING A WORKFORCE

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Besides the numerous employment law considerations connected to layoffs, reductions in workforce, downsizing or similar employee terminations, there are a multitude of employee benefits implications. Below we highlight some of the key employee benefits issues that employers should consider when analyzing reductions in a workforce.*

Severance Arrangements May Constitute ERISA Plans. The Employee Retirement Income Security Act of 1974 (“ERISA”) regulates many severance plans, whether oral or written. While not all severance arrangements are subject to ERISA, arrangements that contemplate “an ongoing administrative program” are likely ERISA plans. There is no bright-line test as to when a severance plan is an ERISA plan, so each severance arrangement should be evaluated on a case-by-case basis. While there are certain advantages and disadvantages to having a severance arrangement subject to ERISA, in either case it is critical for employers to know in advance whether a particular arrangement is subject to ERISA to ensure proper compliance with the applicable requirements.

Changes in the Retirement Plan Participant Counts May Have Vesting Implications. If enough participants are terminated from employment during a certain period of time, a qualified retirement plan may undergo a “partial termination.” If there is a partial termination, all affected employees must fully vest in their retirement benefits. Separate downsizing events (e.g., one in April and one in November) may need to be analyzed together to determine if there is a partial termination. Failure to account for a partial termination could expose a plan sponsor to penalties, including, in a worst case scenario, disqualification of the retirement plan.

COBRA Subsidy Available under the Stimulus Law Requires Immediate Action by Employers. A reduction in force may create continued coverage obligations for health care benefits, whether under the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”) or applicable state laws governing employers not subject to COBRA. As part of the

*This article is intended to address issues surrounding terminations of employment. Different or additional employee benefits issues are implicated with furlough, forced time off, voluntary time off and temporary layoff situations.



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American Reinvestment and Recovery Act (the “Recovery Act”) signed into law on February 17, 2009, employees subject to an involuntary termination of employment from September 1, 2008 to December 31, 2009 are entitled to a subsidy of up to 65% of their COBRA premiums payable by the U.S. government. Eligible COBRA recipients pay reduced premiums, and employers initially make up the difference. Employers are then permitted to take a credit against their payroll taxes for the amount of the reduced premiums. The Recovery Act places several new obligations on employers subject to COBRA or state continuation coverage laws, including notice obligations. For more information, please visit our Client Alert on this topic at <http://www.kutakrock.com/publications/employeebenefits/COBRA021909.pdf>.

Consider Possibility of ERISA Interference Claims. Section 510 of ERISA prohibits an employer from taking adverse employment action or terminating an employee “for the purpose of interfering with the attainment of any right to which such participant may become entitled” under any plan subject to ERISA. Employers may not decide which employees to terminate based on employees’ rights to benefits protected by ERISA (such as vesting status, health claim history, etc.).

Internal Revenue Code Section 409A Restricts Deferred Compensation. Compensation paid out in a year other than the year it is earned is generally considered deferred compensation subject to the tax rules of Internal Revenue Code Section 409A. Companies considering a downsizing must evaluate severance promises to ensure they fit within the constraints of Code Section 409A. Failure to comply with Code Section 409A creates significant tax consequences and penalties for employees.

Regulations Affect Deferrals of Post-Termination Compensation. The Internal Revenue Service has issued new regulations under Code Section 415 that govern when compensation paid after a termination of employment is treated as compensation for qualified retirement plan purposes. In most cases compensation paid after a termination of employment is not compensation for deferral or contribution purposes. Companies should determine if they have timely amended their retirement plans for Code Section 415 and review its rules in determining what compensation to use for plan purposes when post-termination compensation is being paid. (Calendar year plans should have been amended for these regulations by March 16, 2009.)

Pricing Under Vendor Contracts May Be Adjusted. It is common for contracts with employee benefits vendors to provide for pricing based on participant or employee counts. Employers should verify whether a reduction in force will affect the costs under these contracts. To the extent an employer is required to pay for costs associated with terminated employees who remain plan participants, employers could consider alternative plan designs to minimize these costs.



Employers Should Consider Nondiscrimination Testing. Qualified retirement plans, cafeteria plans, self-insured medical reimbursement plans, including health flexible spending arrangements, and dependent care assistance plans are subject to complex nondiscrimination rules under the Internal Revenue Code. Employers should evaluate whether to perform mid-year nondiscrimination testing to address any issues that could result from a reduction in force. In the event a plan fails its preliminary nondiscrimination testing, an employer may adjust the amount its highly compensated employees contribute to the plan to avoid the need to make adjustments at year-end.

This list of possible employee benefits implications of a reduction in force is far from exhaustive. Kutak Rock LLP has an employee benefits and executive compensation practice group whose members work exclusively with employers on the intricacies of employee benefits matters. We welcome the opportunity to work with you in analyzing your changing workforce with an eye toward eliminating legal implications of changes to employee benefits.



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