Benefits & Compensation Priorities to Consider in Advance of the End of 2023

November 2023

As we come to the end of another year, we've prepared an overview of some developments in the benefits area and related action items that should not be overlooked amidst the hustle and bustle of Q4 activity.

Health and Welfare Plans

Amendments to Health & Welfare Vendor Contracts

Employers should consider whether to seek amendments to vendor contracts to address a number of recent disclosure, transparency, and similar legislative and regulatory requirements.

One key recent development is that the Consolidated Appropriations Act 2021 prohibits employers and plans from agreeing to "gag clauses" in their health plan contractual documents. Specifically, employers and plans are prohibited from agreeing that the vendor may refuse to disclose specific cost and quality of care information or data, or de-identified claims and encounter information or data for each participant or beneficiary in the plan or coverage. Group health plans must attest to the government by December 31, 2023, and annually thereafter, that their contracts are in compliance. The problem is that impermissible contract provisions can be embedded in any number of places. To confidently attest to the government, plans would need to review and confirm that there are no gag clauses in every relevant contract and associated attachment, exhibit, schedule, document, procedure, rule, form, manual, spreadsheet, business associate agreement, and other materials.

Benefits teams may want to take the opportunity to meet with their legal advisors to review how to address this and other issues via amendments.

Fertility Benefits

Many employers have considered expanding fertility benefits. In particular, some states have passed laws requiring the provision of fertility benefits for same-sex couples, and there has been speculation that the Biden administration may take steps to follow suit.

Under current regulatory guidance, a great deal of confusion remains over the types of fertility benefits that are taxable versus nontaxable. As a general rule, to be nontaxable, the fertility benefits must qualify as a Code Section 213 medical expense. Medical care includes amounts paid (1) for the diagnosis, cure, mitigation, treatment, or prevention of disease ("disease prong") or (2) for the purpose of affecting any structure or function of the body ("structure or function prong"). Nontaxable medical care therefore includes diagnostic services that establish the cause of infertility and, once a cause is determined, expenses from necessary treatment or assistance for the individual, such as IVF, egg/sperm retrieval and temporary egg/sperm storage.

Current guidance has been addressed in limited case law with respect to fertility benefits for same-sex couples. In 2017, in *Morrissey v. United States*, the 11th Circuit held that medical expenses incurred by a man enabling him and his same-sex partner to become parents were not deductible under Code Section 213 because the expenses for IVF, surrogacy, and egg donation were not to treat the taxpayer's medical condition or to impact the function of the taxpayer's body. In 2021, in Private Letter Ruling 202114001, the IRS followed the holding in *Morrissey*, but noted that medical expenses attributable to sperm donation and sperm freezing were deductible because they did satisfy the structure or function prong based on how they impacted the taxpayer.

Further confusion exists in the area of medical expenses incurred to assist a taxpayer in delaying pregnancy and prolonging fertility, such as egg retrieval and storage, since these expenses are not incurred to overcome a specific disease or impact a body function. Many employer plans differ on both whether to cover these benefits and their approach to the tax treatment.

Particularly as employers add or expand fertility benefits, there should be a review of current and proposed tax treatment for different scenarios and how any involved vendors will administer them.

Retirement Plans

LONG-TERM, PART-TIME EMPLOYEE PLAN PARTICIPATION

The SECURE Act of 2019 added Code Sections 401(k)(2)(D)(ii) and 401(k)(15), which generally require that long-term part-time ("LTPT") employees be permitted to participate in their employer's 401(k) plan. In short, plans that include a service-based eligibility requirement cannot exclude employees who work at least 500 hours for three consecutive 12-month periods. The new requirement does not apply to collectively bargained employees.

In 2023, SECURE 2.0 revised the eligibility from three years to two years for these LTPT employees, effective starting in 2025.

Plan sponsors should decide what they want to do, effective for 2024:

- One option is to comply with the specific requirements of the new LTPT rules. This means tracking hours of service and permitting LTPT employees to enter a plan and make deferrals, but without getting any employer contributions and not being subject to the plan's auto enrollment feature (if it has one). Having at least three years of working at least 500 hours/year will give these LTPT employees access to the 401(k) plan in 2024. Implementation aspects include:
    a. Plan Sponsors would need to make sure their recordkeepers or other service providers (e.g., payroll providers) have counted hours properly and have a mechanism in place to identify newly eligible participants effective each January 1 (or the start of the plan year if it is not a calendar year plan).
    b. Per SECURE 2.0, plans have until December 31, 2025 to make the LTPT amendment.
    c. Even if a plan wanted to make the amendment before January 1, 2024, prototype and volume submitter plans will not have the LTPT amendments ready for adoption this year.

- Some plan sponsors may take a different path by allowing all employees into their 401(k) plans in 2024. Under this option, plan sponsors won't have to worry about counting hours for part-time employees or maintaining two separate benefit structures. Because this is a design change, rather than a legislative amendment, these plan sponsors should amend their plans before the end of the 2023 plan year.

- It is possible that a plan need not make any changes to comply with the LTPT rule, if the plan does not restrict eligibility based on service and instead bases eligibility on some other, non-service-based classification. The IRS has taken the position, however, that some classifications may be a "subterfuge" for a service-based condition, and implementation of the LTPT rules could result in greater enforcement of that IRS position. Plan sponsors should carefully review any such eligibility exclusions to determine the risk that they could be viewed unfavorably.

Required Minimum Distributions

The SECURE Act of 2019 changed the required beginning date from April 1 following the participant's attainment of age 70.5 to April 1 following the participant's attainment of age 72, effective starting in 2020. SECURE 2.0 increased the age to 73, effective starting in 2023 (and then to age 75 starting in 2033). Some plans have chosen to retain an age 70.5 or 72 (or earlier) required payout instead of moving to 73. Pension plans in particular may not want to allow a terminated employee to continue to defer their pension start date. Plan sponsors should confirm their decision and make sure that their plan administration is consistent with their decision.

In addition, starting in 2024, surviving spouses can substitute their age for the participant's age for RMD purposes. This means that, if a participant dies before commencing their benefits, the surviving spouse can elect to use their own age for RMD purposes instead of when the participant would have reached the RMD age.

Payroll, Withholding, and Fringe Benefits

On-Demand Pay

Recent financial technology advancements have given rise to both employer and third-party on-demand pay service arrangements, which enable workers to access their earned wages prior to their next scheduled payday. Depending on the structure of the on-demand pay arrangement, the early receipt, or even availability, of wages can be viewed as a loan or a taxable wage advance, which triggers corresponding employment tax withholding obligations. Employers should be wary about third-party vendors that are aggressively marketing on-demand pay arrangements as loans – especially where the employer is advancing the funds or liable to the vendor for payday shortfalls.

IRS guidance and case law generally distinguish pay advances from the payments of wages based on whether there is a formal and enforceable loan agreement between the payor and the payee. Rev. Rul. 68-239 (advance payments against unearned salary, commissions, or other remuneration for services to be performed are considered wages). In the case of an on-demand pay arrangement administered by a third party, if the arrangement is funded either directly or indirectly by the employer (e.g., the employer is liable for any shortfall owed to the third party), the IRS would likely view the early receipt of wages as a taxable advance. Specifically, on-demand pay arrangements raise constructive receipt concerns (regardless of whether the employees actually receive the early payment) and could trigger a late deposit penalty (because there would not be a corresponding deposit of employment taxes).

Recent Treasury Greenbooks (proposals by the Presidential administration) have contained provisions related to on-demand pay arrangements. Most recently, the FY24 Greenbook indicated that employees with access to an on-demand pay arrangement may be in constant constructive receipt of their wages as they are earned and that employers that offer on-demand pay arrangements should maintain either a daily or a miscellaneous payroll period under current law and should withhold and pay employment taxes on employees' earned wages on a daily basis. Recognizing the hardship associated with this result, the Treasury proposal would amend Code Section 3401(b) to provide that the payroll period for on-demand pay arrangements is treated as a weekly payroll period, even if employees have access to their wages during the week. There have been no additional legislative or IRS updates on this issue.

Taxation of Non-cash Employer-provided Fringe Benefits

As the year's end approaches, it is important to remember the special timing rules applicable to the taxation of noncash employer-provided fringe benefits, such as the personal use of a company plane or other vehicle. In 1985, the IRS provided guidance on the timing and taxation of noncash fringe benefits. See IRS Ann. 85-113, 31 I.R.B. 31 (Aug. 5, 1985). Specifically, the Announcement permits employers to value and tax a noncash fringe benefit provided during a calendar year at any point during the calendar. For example, an employer can use this special rule to include an employee's annual personal use of an employer-provided vehicle in December of each year, rather than having to track and include the value as a taxable benefit on each paycheck.

Furthermore, under a special rule, benefits provided in November and December, or a shorter period in the last two months of the year, may be treated as paid in the following year. An employer may use this rule for some fringe benefits and not others. However, if an employer uses the special accounting period rule for a particular benefit, such as a company plane, it must use the rule for all employees who receive that benefit. Many employers use this special accounting rule for company planes given the complicated calculations necessary to determine the standard industry fare level valuation of mixed personal/business flights.

State Tax Issues for Remote Workers

As a result of the COVID-19 pandemic, the number of employees working from home has dramatically increased, raising issues about the tax treatment of computers, monitors, printers, and other office supplies that employers provide to employees in support of their work-at-home arrangements. In addition, as a general rule, unless a state has a reciprocity agreement with a neighboring state, most states require employers to withhold income taxes based on the location of where the work is physically performed, so remote worker arrangements can trigger an employer's income tax withholding obligation at the employee's work location.

Some of the specific remote worker issues that employers face include:

- New York employers designing and drafting remote work polices such that nonresident employees are not subject to New York's 'convenience of the employer' rule, which taxes the wages of nonresident remote workers;

- Creating sensible payroll policies for withholding state income taxes for remote workers;

- Determining the location of a remote worker's "tax home" and the tax treatment of travel benefits;

- The implications of remote workers and state nexus concerns;

- Determining the remote workers' state source for stock option income and other equity-based compensation.

Year-end is a good time to review these issues and address compliance concerns for the new year.

If you have questions regarding any of these issues, please contact a member of our Benefits & Compensation team.
