



COVID-19: Tax and compensation considerations for employers

Last updated 20 March 2020



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Contents

1. Families First Coronavirus Response Act: paid leave provisions
 - a. *Paid sick leave*
 - b. *FMLA Expansion*
 - c. *Payroll tax credit*
2. Tax relief and other considerations for employees impacted by COVID-19
 - a. *Tax-free employer-provided disaster relief*
 - b. *Medical benefits*
 - c. *Wage advances and loans*
 - d. *Employer-sponsored foundations, charities, and crowdsourcing*
3. Tax implications of employees working from home
4. Retirement plans and severance
5. Impact on compensation practices and certain other arrangements
6. Compensation accounting considerations
7. Additional relief to watch for
8. Contact information

Current as of March 20, 2020

The response to the Coronavirus outbreak is quickly evolving. We will continue to receive additional guidance from federal and state governments which may clarify, expand, or change the topics discussed herein.

Families First Coronavirus Response Act:

Paid leave provisions

H.R. 6201 - Families First Coronavirus Response Act

- ▶ On March 18, 2020, the Senate passed and the President signed the Families First Coronavirus Response Act (“Families First Act”) in response to the outbreak of coronavirus disease 2019 (COVID-19 or Coronavirus). The bill contains several provisions that impact employers, including paid leave provisions and an associated payroll tax credit.
- ▶ The expanded leave requirements will take effect no later than 15 days following enactment and expire on December 31, 2020
 - ▶ Additional guidance on the application of these laws may be provided during this time period

H.R. 6201 - Families First Coronavirus Response Act

- ▶ The following two Acts include expanded paid leave provisions:
 - ▶ The Emergency Paid Sick Leave Act; and
 - ▶ The Emergency Family and Medical Leave Expansion Act.
- ▶ The expanded leave requirements apply to apply to (1) private employers with less than 500 employees and (2) governmental employers regardless of size
 - ▶ The determination of whether a private employer has fewer than 500 employees is not based on tax principles and may require consultation with legal counsel
 - ▶ With respect to leave provided under the Emergency Paid Sick Leave Act, the Secretary of Labor is given authority to exempt businesses with fewer than 50 employees from this requirement if it would jeopardize the viability of a business as a going concern

Emergency Paid Sick Leave Act

Eligible employees

- ▶ Employees are able to receive emergency paid sick leave for the following purposes related to COVID-19:
 - ▶ To self-isolate or quarantine due to a federal, state, or local order
 - ▶ To quarantine on the advice of a health care provider
 - ▶ To obtain a medical diagnosis if the employee has COVID-19 symptoms
 - ▶ To care for someone (not limited to family) experiencing one of the first two situations above
 - ▶ To care for the employee's son or daughter if the school or place of care has been closed, or the child care provider is unavailable
 - ▶ The employee is experiencing another substantially similar condition to those above specified by the Secretary of Health and Human Services in consultation with the Secretaries of Labor and the Treasury
- ▶ Emergency paid sick leave is available for immediate use, regardless of how long the employee has been employed (distinguishable from the FMLA benefits later discussed)

Emergency Paid Sick Leave Act

Duration and amount of paid leave

- ▶ Employees are entitled to up to 80 hours of emergency paid sick leave
 - ▶ Full-time employees are entitled to 80 hours of paid sick leave (the equivalent of 10 eight-hour days)
 - ▶ Part-time employees are entitled to the number of hours that they work, on average, over a 2-week period
- ▶ The emergency leave pay generally equals:
 - ▶ the greater of the employee's regular rate of pay or the applicable minimum wage, capped at \$511 per day and \$5,100 in the aggregate where the leave is used for employee diagnosis, isolation, or quarantine
 - ▶ 2/3s of this amount where the leave is used to take care of another individual who must self-isolate or quarantine, or when a child's school or place of care has been closed or child care is unavailable. In these circumstances, paid leave is capped at \$200 per day and \$2,000 in the aggregate.

Emergency Family and Medical Leave Expansion Act

Eligible employees

An employee is eligible to receive public health emergency leave if the employee is unable to work (either onsite or remotely) and must take leave to care for his/her son or daughter under 18 years of age because:

- ▶ The school or place of care has been closed; or
 - ▶ The child care provider of such son or daughter is unavailable, due to a public health emergency related to COVID-19.
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- ▶ Public health emergency leave is available only for employees who have been with their employer for at least 30 days

Emergency Family and Medical Leave Expansion Act

Duration and amount of paid leave

- ▶ Employees have the right to take up to 12 weeks of job-protected leave
 - ▶ The first 10 days of public health emergency leave may be unpaid. The employee may elect, to take vacation, personal, medical or sick leave during this time
 - ▶ After 10 days, the employer must provide paid leave at a rate of no less than $\frac{2}{3}$ of the employee's regular rate of pay based on the number of hours the employee would otherwise normally be scheduled to work
 - ▶ The paid leave is capped at \$200 per day and \$10,000 in the aggregate

Payroll credit for paid leave wages

- ▶ Any wages required to be paid as a result of these leave provisions are not subject to the employer's share of Social Security Tax (but would be subject to Medicare Tax)
- ▶ Employers are eligible to receive a refundable tax credit equal to 100% of these paid leave wages taken against the employer's portion of Social Security taxes, subject to the caps described herein
 - ▶ The credit for wages is limited to the paid leave required by the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act
 - ▶ The credit may also be claimed for the amount of Medicare Tax due on the required wages and for qualified health plan expenses allocable to the required wages. Those amounts would increase the limitation on the cap by the eligible amount
- ▶ Prohibition on "double-dipping":
 - ▶ Employers must include the amount of the credit in gross income
 - ▶ No credit is allowed with respect to wages for which a credit is claimed under Section 45S

Note: These provisions also apply to compensation subject to Tier 1 of the Railroad Retirement Tax Act. Any compensation required to be paid as a result of the leave provisions are not subject to Tier 1 RRTA and employers are eligible to receive the associated refundable tax credit

Limitations on the payroll tax credit

- ▶ The cap on the credit for wages paid under the Emergency Paid Sick Leave Act is:
 - ▶ \$511 per employee per day, up to a maximum of \$5,100, for amounts paid to employees who must self-isolate, self-quarantine, or obtain a diagnosis
 - ▶ \$200 per employee per day, up to a maximum of \$2,000, for amounts paid to employees caring for another individual (not limited to family) or for the employee's a child whose school or place of care has closed
- ▶ The cap on the credit for wages paid under the Emergency Family and Medical Leave Expansion Act is:
 - ▶ \$200 per individual per day, up to a maximum of \$10,000
- ▶ In the aggregate, an employer might claim up to \$15,100 in credit for a single employee for qualified leave wages. Given that an employer's maximum Social Security Tax per employee for 2020 is only \$8,537.40 ($\$137,700 \times 6.2\%$), the refundability of the tax credits is meaningful

Tax relief and other considerations for employees impacted by COVID-19

- a. Tax-free employer-provided disaster relief
- b. Medical benefits
- c. Wage advances and loans
- d. Employer-sponsored foundations, charities, and crowdsourcing

a. Tax-free employer-provided disaster relief

Employer-provided disaster relief

- ▶ IRC Section 139 exempts a "qualified disaster relief payment" from federal income and employment taxes
- ▶ IRC Section 139 applies when, among other factors, the President declares a "disaster" within the meaning of IRC Section 165(i), which references a Presidentially-declared disaster under the Stafford Act. Revenue Ruling 2003-29 states that a disaster includes, for purposes of IRC Section 165(i), an event declared a major disaster or an emergency under the Stafford Act. On March 13, 2020, President Trump made an emergency declaration, so these provisions apply.

Qualified disaster relief payments

Qualified disaster relief payments include reimbursement or payment of:

Reasonable and necessary:

Personal, family, and living expenses

Temporary housing and transportation expenses

Repair or rehabilitation of a personal residence or its contents

Funeral expenses

Qualified disaster relief payments do not include payments for any expenses compensated by insurance or otherwise

Illustrative employer-provided benefits

Historically, Section 139 benefits have been made available in the context of natural disasters (e.g., severe storms, earthquakes, flooding, fires). The expenses that employees will incur in connection with the Coronavirus pandemic will be different from those incurred by victims of natural disaster. As a result, the determination of what types of nontaxable benefits may be provided will require factual determinations.

Depending on the facts and circumstances, examples of nontaxable payments to employees may include:

- ▶ Reimbursement of private transportation expenses (e.g., Uber, Lyft, taxi) incurred by employees who otherwise commute by public transportation
- ▶ Child-care benefits for employees who lose access to care (e.g., closure of public schools, daycare)

Additional requirements

- ▶ The employer's program must contain requirements to make sure that the grant amounts are reasonably expected to be commensurate with the amount of expenses incurred as a result of the disaster, and the employee did not receive reimbursement for such expenses from other sources (e.g., insurance)
- ▶ In prior disasters, the IRS found that employees were not required to provide proof of actual expenses in order to qualify for the Section 139 exclusion from income. At this time, it is unclear whether the same standard will be applied in connection with the Coronavirus. Regardless, many employers may want to request substantiation for cost management purposes and to document the benefit paid to the employee is not in excess of actual expenses incurred less insurance proceeds or other assistance received from other sources.

b. Medical benefits

One-off medical benefits

- ▶ Depending on the facts and circumstances, employers may be allowed to provide one-off medical benefits for individual employees and their family members
- ▶ Considerations include:
 - ▶ “Plan” requirement
 - ▶ Nondiscrimination rules
 - ▶ Group health plan rules
 - ▶ Nontax legal requirements and prohibitions
 - ▶ HDHP/HSA eligibility (but see next slide)

Special guidance for high-deductible health plans

- ▶ Notice 2020-15 allows (1) high-deductible health plans (HDHPs) to permit COVID-10 testing and treatment without having the minimum deductible satisfied and (2) individuals to maintain their health savings accounts (HSAs) when using these benefits
- ▶ As a result, employers are permitted to change the terms of a group health plan or insurance contract to provide treatment for COVID-19 before deductibles or out-of-pocket limits have been met

Group health plan coverage

- ▶ The Families First Coronavirus Response Act requires group health plans and health insurance issuers offering group or individual health insurance coverage to cover COVID-19 testing without cost sharing, even if the plan continues to be grandfathered from certain requirements of the Affordable Care Act
- ▶ This requirement extends to related items or services furnished at the health care provider visit that resulted in COVID-19 testing

c. Wage advances and loans

Wage advances

- ▶ To cover immediate expenses incurred by employees impacted by the Coronavirus, employers may wish to consider paying employees an advance on future wages
 - ▶ The advance would be taxable to the employee at the time of payment, unless excludible under Section 139 as a disaster relief payment
 - ▶ Employers should verify that any accelerated payment of future compensation does not create adverse consequences under Section 409A
 - ▶ If any wage advances are required to be repaid to the employer in a future year, the “claim-of-right” doctrine may result in complex reporting for employers and potentially adverse tax consequences to employees

Employee loans

- ▶ Employers may wish to consider granting loans to assist employees with expenses incurred in connection with the Coronavirus
- ▶ A below-market interest or interest-free loan may be provided to an employee without triggering taxable income if the employee's daily aggregate loan balance doesn't exceed \$10,000
- ▶ There must be a loan agreement at the time of the cash exchange that shows the employee is required to make loan payments and the employer intends to, and in fact does, enforce the payment requirement
- ▶ Imputed income will arise if:
 - ▶ The loan balance exceeds \$10,000 and there is below-market interest, or
 - ▶ The loan balance is forgiven

Note: Sarbanes-Oxley prohibits loans to executive officers and directors

Employee loans, *cont'd*

- ▶ The loan must not operate in the nature of a salary advance:
 - ▶ The loan should not be conditioned on future events (e.g., achieving sales or other performance goals)
 - ▶ If there is a provision that the loan payments will be made only from a certain source (e.g., payroll deduction), there should be a reasonable prospect that the loan can be repaid from this source
 - ▶ There should be definite plans and schedules for the repayment of principal amounts, and there should be actions stipulated that the employer will take to enforce such payment schedules
 - ▶ The employer may not take a deduction for the principal portion of the employee loan (i.e., loans are treated as a liability on the balance sheet)
 - ▶ Employee loan repayments, if deducted from wages, should be made on an after-tax basis (i.e., there should be no agreement to forgo or reduce gross salary in repayment of the loan)

d. Employer-sponsored foundations, charities, and crowdsourcing

Employer-sponsored foundations

- ▶ Employer-sponsored foundations may be used to provide relief to employees affected by the Coronavirus:
 - ▶ Payments are made only to employees or their family members who are affected by qualified disasters
- ▶ The IRS will generally presume that qualified disaster relief payments made by a private foundation to employees (or their family members) are consistent with the foundation's charitable purposes if the following requirements are met:
 - ▶ The class of beneficiaries is large or indefinite
 - ▶ The recipients are selected based on an objective determination of need
 - ▶ The selection is made using either an independent selection committee or adequate substitute procedures to help ensure that any benefit to the employer is incidental and tenuous. The selection committee will be deemed independent if a majority of its members consists of people who are not in a position to exercise substantial influence over the affairs of the employer

Employer-sponsored foundations, *cont'd*

- ▶ If these requirements are met, the foundation's qualified disaster relief payments:
 - ▶ Are treated as made for charitable purposes
 - ▶ Do not result in prohibited self-dealing merely because the recipient is an employee (or family member of an employee) of the employer-sponsor
 - ▶ Do not result in taxable compensation to the employees. This presumption does not apply to payments that would otherwise constitute self-dealing (e.g., payments to individuals who are officers, directors or trustees of the foundation).
- ▶ These provisions do not apply to payments made to members of the foundation's grant selection committee

Employer-sponsored foundations, *cont'd*

- ▶ Because public charities are typically more transparent and are subject to a greater amount of public scrutiny due to their broad sources of financial support, they have more flexibility regarding the assistance they may provide to employees
- ▶ The same requirements that apply to employer-sponsored foundations apply to employer-sponsored charities, except:
 - ▶ Public charities may establish employer-sponsored employee assistance programs to assist in any type of disaster or hardship situation (i.e., qualified or non-qualified) as long as the employer does not exercise excessive control over the organization

Employer-sponsored donor-advised funds (DAFs)

- ▶ A DAF exists when a foundation or other public charity maintains a separate fund or account to receive contributions from individual donors and the donor receives advisory privileges over investment or distribution of the donated funds
- ▶ Generally, DAFs may only make grants to other IRC§ 501(c)(3) public charities and cannot make grants to individual persons
 - ▶ An exception is made for certain employer-related funds or accounts that are established to benefit employees (or their family members) that are affected by a qualified disaster
 - ▶ In addition to the requirements that apply to private foundations and charities, the DAF must be established to serve the single identified purpose of providing relief to employees and family members of the employer sponsor from one or more qualified disasters

Employer-sponsored donor-advised funds (DAFs), *cont'd*

- ▶ Also, similar to the requirements of employer-sponsored private foundations, the DAF may not provide a benefit to any director, officer or trustee of the sponsoring organization or to members of the fund's selection committee
- ▶ The DAF must maintain adequate records that demonstrate the need for the assistance provided

Employer-established crowdsourcing accounts and accounts other than tax-exempt entities

- ▶ Employers establish “funds” in the employer’s name to collect contributions from employees on an after-tax basis
 - ▶ Employer is the legal owner of the assets contributed to the fund and has the right to direct who will receive payments from the fund and how the distributions will be made
 - ▶ Examples include a separate bank account or a GoFundMe account through PayPal
- ▶ Contributions to the fund established by an employer and any earnings on the contributions are income to the employer who is the legal owner of the fund and controls the distributions
- ▶ Depending on the facts and circumstances, payments made by employers from the fund to affected employees may be:
 - ▶ Compensatory and are deductible to the employer under Section 162 in the taxable year the payments are made
 - ▶ Nontaxable to employees as “qualified disaster payments” under Section 139 as long as distributions are reasonably designed to provide funds that do not exceed the affected employee’s unreimbursed expenses

Tax implications of employees working from home

Needs of the remote workforce

- ▶ In an effort to contribute to the containment of new Coronavirus infections, some employers are asking employees to self-quarantine, work from home, and/or avoid public transportation
- ▶ Employees who are asked to work from home may need additional accommodations to remain productive:
 - ▶ Internet and phone service
 - ▶ Technology hardware (e.g., laptop, additional monitor)
 - ▶ Technology software
 - ▶ Additional child care
- ▶ Whether the fringe benefit may be provided on a non-taxable basis will depend on the facts and circumstances including whether the benefit is sufficiently connected to the business of the employer and/or the Coronavirus pandemic

Employees working from home

- ▶ Where an employee's home is in a different state or locality from the employee's normal work location, a number of tax issues should be considered:
 - ▶ Nonresident (work location) state income tax withholding
 - ▶ "Convenience of the employer" rule - CT, DE, NE, NYS, and PA
 - ▶ Is the telecommuting for convenience of the employee or necessity of the employer?
 - ▶ Should employer still continue withholding this tax?
 - ▶ Resident state income tax withholding
 - ▶ Does reciprocity exist between states the resident state and the work location state?
 - ▶ Local income and employment tax considerations
 - ▶ State unemployment insurance
 - ▶ Employer and business registration requirements for temporary work locations
 - ▶ Filing and payment of state and local business taxes
 - ▶ Will states issue guidance on how to handle these situations?

Retirement plans and severance

Pensions and other post-retirement employee benefits (OPEB)

- ▶ Lower interest rates and falling asset values may trigger additional ERISA funding contributions in the future
- ▶ Companies may need to reconsider cash availability to make anticipated contributions within 8.5 months of prior year-end to receive tax deductions
- ▶ The assumed discount rate and expected long-term rate of return assumptions continue to be determined at the annual measurement date, unless an interim event requires an earlier remeasurement (e.g., curtailment, settlement)
 - ▶ Actuarial gains and losses will be determined at the measurement date

Pensions and OPEBs

| | |
|---------------------|---|
| Funding/tax | <ul style="list-style-type: none"> ▶ Lower interest rates and asset values may increase 2021 pension funding requirements, unless the IRS extends existing funding relief currently set to begin wearing off in 2021, as well as PBGC premiums and PBGC reporting requirements ▶ Companies may postpone current year discretionary funding, or even required funding <ul style="list-style-type: none"> ▶ Missing required funding may result in late penalties and PBGC reporting requirements ▶ Some union agreements may restrict ability to delay funding ▶ Government contractors may lose ability to recover costs for late contributions ▶ Funding waivers may be obtainable for companies with temporary business challenges ▶ Non-cash contributions may be an option, subject to prohibited transaction rules ▶ Consider feasibility of using OPEB VEBA trusts for other eligible expenses |
| Financial reporting | <ul style="list-style-type: none"> ▶ The assumed discount rate and expected long-term rate of return assumptions should continue to be determined at the annual measurement date, unless an interim event requires an earlier remeasurement (e.g., curtailment, settlement) ▶ Consider potential impact on items such as loan covenants and goodwill impairment ▶ Communications with investors may be needed regarding potential financial impact |
| Design | <ul style="list-style-type: none"> ▶ Lump sum windows may be more attractive, and may be more available to some actives due to the SECURE Act and are available to retirees due to IRS Notice 2019-18 ▶ Funding levels may result in benefit restrictions ▶ Early retirement windows may help right-size workforce |

Supplemental unemployment benefit plans (SUB Plans)

- ▶ Employers who pay severance benefits may be able to realize FICA and FUTA savings as well as a reduction in the actual dollars spent on the separation payments by structuring these payments under a Supplemental Unemployment Benefit (“SUB”) plan
 - ▶ Participants may gain up to 7.65% more of a benefit per payment since a SUB plan is not subject to FICA taxes
- ▶ To qualify for the FICA and FUTA exemption, the SUB benefits must be linked to the recipients' state unemployment insurance (“SUI”) benefits under conditions set forth in a series of IRS revenue rulings. General considerations include:
 - ▶ SUB plan participants must be eligible and register for SUI benefits
 - ▶ SUB plan benefits must be paid on a periodic basis (no lump sum payment)
 - ▶ SUB payments must stop when recipients find new employment or otherwise become ineligible for SUI benefits (except where ineligibility is due to exhaustion of SUI benefits)
 - ▶ Sum of periodic SUB and SUI benefits may not exceed a recipient’s pre-separation periodic pay

Impact on compensation practices and certain other arrangements

Compensation practices

- ▶ With the sharp decline in stock values and uncertainty of the financial markets brought on by COVID-19, companies will be forced to consider alternative approaches in their compensation arrangements
- ▶ The emergence of certain practices we are starting to observe are as follows:
 - ▶ Performance-based incentives (PSUs, annual bonuses, commission-based arrangements):
 - ▶ Developing methodologies for isolating the impact that COVID-19 will have on financial performance and determining a more “normalized” level of achievement against pre-established goals attributable to performance-based plans.
 - ▶ Adding / exercising discretion in the determination of pay-outs.
 - ▶ Shifting of performance weighting factors from absolute measures to relative measures (against peers).
 - ▶ Alternative approaches depending upon whether award delivered in cash or shares
 - ▶ For equity grants going forward - consideration as to the burn rate and shares reserved. Does the Company have enough shares? How will these considerations impact the type of equity awards granted?

Compensation practices, *cont'd*

- ▶ Additional consideration to the following practices are as follows:
 - ▶ Shifting to cash-based arrangements such as “phantom plans” or deferred compensation arrangements to mitigate dilution implications of share-based plans
 - ▶ Modification of deeply “underwater” stock options via reduction to strike price
 - ▶ Interim shift to non-performance based arrangements (e.g., RSUs)
 - ▶ Restricted stock award grants allowing for Section 83(b) elections at depressed stock prices
 - ▶ Delay of new share-based grants beyond normal award timing with expectation of the market settling to more “normalized”, predictable levels

Compensation practices, *cont'd*

- ▶ Implications of any and all approaches will need to be carefully considered:
 - ▶ There will be need to balance shareholder reaction to any changes to incentives that would be perceived as favorable to executives - requires careful consideration of business case / rationale and shareholder outreach
 - ▶ Determine Board procedures and SEC disclosure requirements associated with adoption of changes made to incentive programs
 - ▶ Dilution and EPS impact that existing or amended share-based practices will have - due to dramatically depressed stock prices, any new share grants (or issuances) that are based on dollar values (as part of one's compensation package) will not only eat away at share reserve pools but can result in material share dilution and EPS reduction
 - ▶ Consider cash-flow impact on any shift to a cash-based approach
 - ▶ Tax consideration including potential loss of "grandfathering" under Section 162(m) and Section 409A compliance issues
 - ▶ GAAP and IFRS accounting implications - e.g., a modification to performance goals from "improbable" to "probable" or a reduction of strike price for "underwater" options will likely lead to material accounting charges that will adversely impact EPS

Other arrangements

- ▶ Employee stock purchase plans (ESPPs) - evaluation of the impact that market dislocation will have on utilization and financial projections associated with “look-back” and discount features; potential need for plan suspension or redesign
- ▶ 401(k) plans with employer stock investment options and employee stock ownership plans (ESOPs) - potential suspension of investments in employer stock accounts; potential suspension of stock contributions to ESOPs; for leveraged ESOPs, consider impact of fluctuation in expense recognition attributable to shares released from suspense accounts
- ▶ Defined benefit pension plans / SERPs - sharply reduced plan asset values will likely have a material impact on plan funding requirements and GAAP and IFRS accounting implications; adoption of actuarial “smoothing” techniques should be considered
- ▶ “Funded” NQDC arrangements - to the extent asset values held in a “rabbi trust” differ from hypothetical investment options, there can now be a material mismatch in “funded” amounts versus plan obligations - could be either favorable or unfavorable to the company
- ▶ Impact of financial implications associated with change in control and severance provisions

Compensation accounting considerations

Modifications to share-based payment awards

- ▶ Modifications may become more prevalent to keep employees incentivized. Key considerations include:
 - ▶ Repricing options or adjusting performance vesting conditions (e.g., sales goals) to make easier to achieve
 - ▶ Modification accounting depends on whether the award is probable of vesting
 - ▶ For “probable” equity awards, incremental cost is likely to be triggered (based on the difference in FV immediately before and after the modification)
 - ▶ For “improbable” equity awards, the grant date fair value of the original award is no longer relevant. The cost of the award is updated based on the modification date fair value
 - ▶ Valuation considerations:
 - ▶ Black-Scholes may no longer be appropriate if award is out-of-the-money
 - ▶ Simplified method of calculating the term may no longer be appropriate
 - ▶ Expected volatility may need to be reconsidered in the current environment
- ▶ Awards may be accelerated for terminated employees
 - ▶ May result in additional compensation at the time of modification/acceleration

Other compensation

- ▶ Cash bonuses
 - ▶ Entities continue to recognize bonuses based on the expected payment amount
 - ▶ Modifications should result in the liability being adjusted accordingly
- ▶ Fringe and non-monetary benefits (e.g., free or subsidized goods/services)
 - ▶ Consider additional benefits that may be provided
 - ▶ Typically measured at the cost of the benefit to the employer
 - ▶ Recognize as costs are incurred in the same manner as benefits payable in cash

Additional relief to watch for

Additional relief that may become available

- ▶ Retirement plan loans and hardship distributions
- ▶ Retirement plan 10% early distribution tax
- ▶ Employee leave sharing
- ▶ Employer-facilitated gifts among employees
- ▶ Section 125 cafeteria plan election relief
- ▶ Pension funding relief
- ▶ Additional HSA relief

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