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Compensation and benefits provisions of the American Rescue Plan Act of 2021

Tax Alert

Overview

On March 10, 2021, Congress passed the American Rescue Plan Act of 2021 (the "Act"), which includes several provisions that affect employer tax deductions and credits and funding of pension plans. President Biden is expected to sign the legislation this week. The provisions of the Act include:

- Expansion of the definition of "covered employee" under section 162(m) of the Internal Revenue Code ("Code");
- Enhancements to the employee retention tax credit and extension of the credit to qualified wages paid through December 31, 2021;
- Modifications to the payroll tax credit for qualified wages paid to employees due to sick leave or expanded family and medical leave for reasons related to COVID-19 and extension of the credit by two calendar quarters through September 30, 2021;
- COBRA premium assistance for eligible individuals and their families and a corresponding payroll tax credit for employers and others that pay the subsidized portion of the COBRA premium, and certain other changes to COBRA;
- Increase in the individual tax exclusion for employer-provided dependent care assistance;
- Funding relief for single employer pension plans; and
- Both funding relief and funding assistance for certain multiemployer pension plans.

Amendments to Section 162(m)

The Act expands the definition of "covered employee" under Code section 162(m), which generally limits to $1 million the deduction allowed to a publicly held corporation for compensation paid to a covered employee for a taxable year. Under prior law, a covered employee was generally defined as (i) the principal executive officer ("PEO") and the principal financial officer ("PFO") at any time during the taxable year (and any individual acting in that capacity); (ii) the three highest compensated executive officers for the taxable year, other than the PEO and PFO; and (iii) any individual who was a covered employee in any preceding taxable year beginning after December 31, 2016.

The Act expands that definition to include the next five highest compensated employees for taxable years beginning after December 31, 2026, other than the individuals described in (i) and (ii).

> ***Observation:*** The next five highest compensated individuals newly added to the definition of covered employee by the Act are not limited to executive officers of the publicly held corporation, as opposed to the current rule which requires the PEO, PFO, and three highest compensated individuals to be executive officers of the publicly held corporation. It appears that any employee could be among the next five highest compensated employees under the new provision. The effect of the provision under the Act is to double from five to ten the minimum number of section 162(m) covered employees determined for any given tax year beginning after December 31, 2026. However, it appears that the rule providing that a covered employee includes any individual who was a covered employee for a taxable year beginning after December 31, 2016 (sometimes referred to as the "once a covered employee always a covered employee" rule) does not apply to the next five highest compensated employees added by the Act.

Employee Retention Tax Credit

The Coronavirus Aid, Relief, and Economic Security ("CARES") Act allowed certain employers to claim a credit against the employer portion of the Old-Age, Survivors and Disability Insurance ("OASDI") tax of the Federal Insurance Contributions Act ("FICA") (or the equivalent amount under the Railroad Retirement Tax Act ("RRTA")) for certain qualified wages. The credit was expanded and extended under the Consolidated Appropriations Act, 2021 (P.L. 116-260). Prior to the Act, the credit applies to wages paid after March 12, 2020, and before June 30, 2021. For 2021, the credit is equal to 70 percent of qualified wages up to $10,000 per employee per calendar quarter.

The Act extends the employee retention tax credit to wages paid through December 31, 2021, and modifies the credit such that it is a credit against the employer's share of the Hospital Insurance ("HI") portion of FICA (and the equivalent amount of RRTA tax) effective for wages paid after June 30, 2021. The Act also provides enhancements to the employee retention tax credit by allowing certain hard hit businesses to count wages paid to all employees as qualifying wages (rather than just those wages paid to employees who are not providing services) and by making the credit available to certain start-up businesses, subject to certain limits. It also would clarify that employers that were not in existence in 2019 must use their average number of 2020 employees for purposes of determining the credit wage base and that qualified wages do not include wages taken into account as payroll costs under certain Small Business Administration programs. Similar aggregation rules for employers apply as in last year's CARES Act.

Credits for Paid Sick and Family Leave

The Families First Coronavirus Response Act ("FFCRA") required certain employers with fewer than 500 employees to provide paid sick leave and expanded family and medical leave to employees who were unable to work for reasons related to COVID-19, and it allowed a tax credit against the employer portion of OASDI taxes for qualified sick leave wages and qualified family leave wages. The paid sick leave and expanded family and medical leave requirements of the FFCRA expired on December 31, 2020, but the tax credit for qualified sick leave wages and qualified family leave wages (including wages and compensation that would have been qualified sick leave wages and qualified family leave wages if the mandatory paid sick and expanded family and medical leave provisions of the FFCRA had remained effective) was extended until March 31, 2021.

The Act generally extends the credit to leave taken between April 1, 2021, and September 30, 2021, and makes certain modifications to the credit for this period. These modifications include an increase to the maximum paid qualified family leave wages that can be used for calculating the credit from $10,000 to $12,000, an expansion of the reasons for leave that qualify for the credit, an amendment to the overall limitation on the number of days that can be taken into account for purposes of the credit, and the addition of a nondiscrimination provision prohibiting an employer from claiming the credit if the employer provides leave in a manner that discriminates in favor of highly compensated employees, full-time employees, or based on tenure with the employer. The Act also increases the credit by the amount of OASDI and HI taxes (and the equivalent portions of RRTA tax) on qualified sick leave wages and qualified family leave wages for which a credit is allowed and provides that, after March 31, 2021, the credit will be allowed against the employer portion of HI tax, instead of the OASDI portion.

COBRA Premium Financial Assistance

The Act provides that assistance eligible individuals and their families generally are not required to pay COBRA premiums beginning on the first day of the month following enactment of the legislation through September 31, 2021 (i.e., April 1 through September 31), subject to certain limits, and it allows a credit against the employer portion of HI tax to the employer, group health plan, or insurer to which premiums are payable in an amount equal to the unpaid premium. Assistance eligible individuals are generally defined as individuals who are eligible for COBRA continuation coverage because of termination of employment, other than voluntary termination of employment. Among other changes, the Act also provides an extension of the COBRA election period, a limited ability to change coverage during the COBRA continuation period, and an expedited review process for denials of premium assistance. It also requires certain notices to affected individuals.

Dependent Care Assistance Exclusion

Prior to the Act, an employee could generally exclude from taxable gross income up to $5,000 for employer-provided dependent care assistance under a dependent care assistance program meeting certain conditions. The Act generally increases the tax exclusion from $5,000 to $10,500 for 2021.

Single Employer Pension Plan Relief

Prior to the Act, funding shortfalls in single employer pension plans were required to be amortized over seven years. For this purpose, a plan's funding shortfall is the difference between the present value of accumulated benefit obligations under the plan over the value of plan assets. This is referred to as the "shortfall amortization base." The shortfall is calculated annually as of the beginning of the year, and the amount necessary to amortize the shortfall (as well as the shortfall from prior years) is a component of the required annual contribution to the plan for the year. The Act extends the amortization period to 15 years for plan years beginning after December 31, 2021, and further allows an employer to elect the 15-year amortization period for plan years beginning after December 31, 2019, and December 31, 2020. The Act also provides that all shortfall amortization bases for the 2021 plan year (and also the 2019 or 2020 plan year, if the plan sponsor elects 15-year amortization for those years), and all shortfall amortization instalments determined with respect to these bases are reduced to zero.

The Act also modifies and extends the interest rate smoothing that would have begun to phase out in 2021. In order to calculate the present value of benefit liabilities under a plan, plans must use rates tied to the currently prevailing yield on corporate bonds of varying maturity. In prior legislation, Congress provided that these interest rates, so determined, must be within 10 percent higher and 10 percent lower of 25-year interest rate averages. Beginning in 2021, this 10 percent corridor around the 25-year average rate was scheduled to increase by 5 percent each year until interest rates would only need to be within 30 percent higher or lower of the 25-year average.

The Act reduces the interest rate corridor to 5 percent of the 25-year interest rate average for 2020 and provides that this 5 percent corridor will begin to phase out in 2026 when, as under current law, the corridor will increase by 5 percent each year until interest rates must be within 30 percent of the 25-year average. The corridor would then remain at 30 percent permanently. In addition, the Act provides that the 25-year interest rate average used in these calculations will, in no event, be less than 5%.

Multiemployer Pension Plan Relief

Multiemployer pension plans are collectively bargained pension plans meeting certain requirements that are maintained by two or more unrelated employers and a labor union. Approximately 10 million American workers participate in these plans, and about 1.3 million of these workers are in multiemployer pension plans that are projected to become insolvent in the near future. The Act provides significant relief for these plans.

Most notably, the Act establishes a program under which the Pension Benefit Guaranty Corporation ("PBGC") will make cash payments to certain severely underfunded multiemployer pension plans to ensure that they can continue to pay retirement benefits. The payments will be made in a single lump sum and will be equal to the amount needed for the plan to pay all benefits due during the period beginning on the date of enactment of the legislation and ending in 2051. Plans are required to invest the relief payment in investment grade bonds or other investments permitted by the PBGC. Plans may apply for assistance under the program no later than December 31, 2025, and the program will be financed through a general Treasury transfer.

The Act also increases the PBGC multiemployer plan premium rate to $52 per participant beginning in 2031, indexes that premium for inflation, and makes certain changes to the funding status and amortization rules applicable to multiemployer plans.

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