Benefits and Employment Briefing

QUARTERLY NEWSLETTER

Fall 2015

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The Surprising Compliance Issues of High Deductible Health Plan/Health Savings Account Arrangements

As the Patient Protection and Affordable Care Act (ACA) comes into complete fruition, many employers are offering to employees High Deductible Health Plans (HDHPs) and facilitating the establishment and funding of Health Savings Accounts (HSAs). The HDHP design helps employers offer employees a plan that is "affordable" under the ACA. The HSA allows employees to save for current and future year medical expenses on a pre-tax basis and thus ameliorate the burden of higher annual deductibles.

While the HDHP and HSA design provides benefits to both employers and employees, the design is not without its compliance challenges. Many employers are surprised to discover, after they establish an HDHP and HSA plan design, that they have failed to take certain compliance requirements into account.

For example, in order to be eligible to contribute deductible or pre-tax contributions to an HSA, an employee must be enrolled in an HDHP and may not have any other health coverage under a plan which is not an HDHP. This means, first, that an employee may participate in an HDHP without having an HSA, but the employee may not contribute on a tax-deductible or pre-tax basis to an HSA without participating in an HDHP, to the exclusion of any other health plan.

An employee who has family coverage under an HDHP and a spouse with family coverage under a non-HDHP is eligible to fund an HSA on a tax deductible or pre-tax basis, up to the family limit. The lowest annual deductible of the employee and spouse plans will also be attributed to both the employee and the spouse. The employee is not rendered ineligible to fund an HSA; however, no portion of the employee's contribution may be allocated to the ineligible spouse.

Participation in a medical flexible spending arrangement under a Code § 125 plan will render an employee ineligible to fund an HSA on a tax-favored basis. However, an employee may participate in a limited purpose flexible spending arrangement—one that offers only vision, dental, or other non-health plan benefits—and maintain eligibility to fund an HSA.

Variations in HDHP designs also present surprising challenges. For example, under the Internal Revenue Code ("Code") § 223, the tiers of EE+Child, EE+Spouse, and EE+ Family are all considered "employee plus family." If differences in the annual deductible amounts exist among these tiers, the lowest annual deductible for, say EE+Child, must still be over the minimum annual deductible amount for EE+Family coverage in the applicable year.

A compliance issue may arise due to the comparability rules associated with HDHP and HSA designs. Employer contributions to HSAs are governed by the comparability rules under Code § 4980G. The comparability rules require that if an employer chooses to make HSA contributions on behalf of an employee, the employer must make comparable contributions to HSAs of all comparable participating employees. Failure to make contributions according to the comparability requirements set forth under the Code will subject the employer to an excise tax equal to 35% of the aggregate amount contributed by the employer during the plan year.

"Comparable contributions" for HSA purposes are those which are the same monetary amount or which are the same percentage of the annual deductible limit under the HDHP for comparable participating employees. "Comparable participating employees" are defined in the Code as all employees who are eligible individuals covered under the HDHP of the employer and having the same category of coverage. The Code sets out only two categories of coverage: self-only HDHP coverage and family HDHP coverage. However, if an employer provides different categories of family coverage based upon the number of individuals covered by the HDHP, the comparability rules may be applied separately to each family category. The HDHP family categories for purposes of the comparability analysis are self+one, self+two, and self+three or more.

Comparability issues may be avoided entirely by having employer contributions made to an HSA on a pre-tax basis through a Code § 125 plan. Under these circumstances, the comparability rules do not apply and the employer's contribution is subject to the coverage and non-discrimination rules applicable to Code § 125 plans.

The ACA has raised new interest among employers in HDHPs. Employers are advised, however, to seek counsel regarding their HDHP and HSA arrangements and to carefully educate employees regarding the requirements for eligibility to fund an HSA on a tax-favored basis.

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ACA Cadillac Tax: IRS Issues Next Installment of Preliminary Guidance

In February, employers, administrators and others got to see some preliminary thoughts the Internal Revenue Service (IRS) has about the so-called "Cadillac Tax," included in the Affordable Care Act (ACA). That initial glimpse came when the IRS issued Notice 2015-16. At the end of July, the IRS issued its second installment, Notice 2015-52. After considering the comments its receives in connection with both Notices, the IRS expects to issue proposed regulations, at which time comments will again be requested and considered before any final rules are imposed. If you would like to send comments to the IRS concerning any of the proposals in Notice 2015-52, email those comments to Notice.comments@irscounsel.treas.gov with "Notice 2015-52" in the subject line **no later than October 1, 2015**.

What is the "Cadillac Tax?"

The ACA added a new excise tax under section 4980I of the Internal Revenue Code ("Code") that applies to tax years after December 31, 2017. The tax seeks to discourage high-cost health plans and applies, in general, when the aggregate cost of employer-sponsored coverage – referred to as "applicable coverage" – exceeds a statutory dollar limit. That excess is subject to a 40 percent nondeductible excise tax.

Notice 2015-15

IRS Notice 2015-16 describes potential approaches regarding a number of issues under Code § 4980I. These include (1) the definition of applicable coverage, (2) the determination of the cost of applicable coverage, and (3) the application of the dollar limit to the cost of applicable coverage to determine any excess benefit subject to the excise tax. Read a more detailed discussion of the contents of that notice.

Notice 2015-52

Notice 2015-52 builds on Notice 2015-16 by addressing additional issues under § 4980I, including:

- **Who is liable for the excise tax**

  The liability for the tax will fall on "coverage providers." For insured plans, this generally will be insurance carriers. For coverage under HSAs or Archer MSAs, the coverage provider will be employers. The third category of coverage provider is "the person that administers the plan benefits." This category will capture self-funded plans, but the IRS is not sure how it should be defined and seeks comments on two approaches discussed in the Notice.

- **Issues for employers that are part of groups of organizations under common control**

  The IRS recognizes that for employers that are part of controlled groups, a number of issues will have to be addressed. These include identifying (1) the coverage made available by employers in the group, (2) the employers that will be responsible to calculate and report the excess benefit, and (3) the employers liable for improperly calculating the tax. The IRS requests comments on all of these issues.

- **Pass-throughs and gross-ups concerning the tax**

  The IRS recognizes that coverage providers liable for the tax may, nonetheless, pass the cost of the tax along to others that may reimburse the coverage provider for having to pay the tax. The IRS addresses the tax treatment of these pass-throughs and reimbursement payments, including how to calculate gross-ups of those payments for tax purposes.

- **Notice and payment of the tax**

  Under Code § 4980I, employers must (1) calculate the excess benefit subject to the tax and the share of that excess benefit for each coverage provider, and (2) notify the IRS and the coverage providers of those amounts. The IRS is looking for input on the form and timing of those notice requirements, among other issues. Also, as with the PCORI fee, the IRS intends to

designate Form 720 as the method to pay the tax.

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EEOC Rules that Discrimination against LGBT Workers Is Unlawful

On July 17, 2015, the Equal Employment Opportunity Commission (EEOC) ruled that workplace discrimination on the basis of sexual orientation is illegal under the federal Civil Rights Act of 1964, as a form of sex discrimination. In a 3-to-2 vote (along party lines), the Commission concluded that while the Civil Rights Act did not explicitly prohibit discrimination against gays and lesbians, "an allegation of discrimination on the basis of sexual orientation is necessarily an allegation of sex discrimination."

In the past, most courts have ruled that Title VII of the Civil Rights Act of 1964 does not prohibit discrimination based on sexual orientation, because sexual preference is not explicitly mentioned in the statute. Further, as many as 28 States permit an employee to be discriminated against, and even discharged, based on his or her sexual orientation and gender identity. The EEOC's new ruling disputes these rulings and laws. The EEOC concluded that "Sexual orientation discrimination is sex discrimination because it necessarily entails treating an employee less favorably because of the employee's sex." The Commission asserted that if an employer discriminated against a gay female employee for displaying a photo of her wife, but not a heterosexual male employee for showing a photo of his (female) wife, that action would constitute unlawful sex discrimination.

The EEOC's ruling could be applied to alleged discrimination that may arise in the context of a range of employment actions; like hiring, promotion and discharge decisions, and to employees' working conditions, such as claims of workplace harassment. This ruling will govern complaints that are filed with any office of the Commission, and though the ruling is not necessarily binding on federal courts, courts often defer to federal agencies in interpreting laws which fall within that agency's area of expertise and jurisdiction.

The EEOC's ruling follows a similar ruling in the 2012 case of *Macy v. Holder*, in which the EEOC held that discriminating against employees on the basis of their *gender identity* was inherently sex discrimination and therefore outlawed by Title VII. Since 2012, several transgender plaintiffs have won claims in federal courts which followed that ruling.

The existing ruling by the Supreme Court which is instructive on this issue, *Price Waterhouse v. Hopkins (1989)*, held that a female employee who didn't present herself in a stereotypical feminine manner could establish a claim of sex discrimination when she wasn't promoted for that reason. However, gay, lesbian and bisexual plaintiffs essentially had to graft arguments based on "gender nonconformity," however ill-fitting, to make out their claims. For example, a gay man might argue that he was discriminated against for not appearing sufficiently masculine, but would have little success arguing that he was discriminated against simply for being in a same-sex relationship. Under the Commission's new ruling, however, plaintiffs may now argue that they are being discriminated against based upon their sexual orientation, an argument which will substantially broaden the scope of Title VII.

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Reducing Employee Hours to Avoid ACA Obligations to Offer Coverage Violates ERISA § 510, Class Action Suit Alleges

One strategy for minimizing exposure to the employer shared responsibility penalties under the Affordable Care Act (ACA) is to minimize the number of "full-time employees" – that is, the number of employees working 30 or more hours per week on average. Employers can accomplish this through reducing the number of hours certain current and future employees work so that they will not be considered to be "full time" as defined by the ACA, requiring coverage to be offered to a smaller group or none at all. One company's alleged attempt to do just that is the central claim in a class action lawsuit by an employee alleging the company has interfered with her rights to benefits under ERISA. (*Marin v. Dave & Buster's, Inc.*, S.D.N.Y., No. 1:15-cv-03608)

The claims are based on Section 510 of ERISA. The relevant section of that law provides:

> It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan, this title, section 3001 [29 USC §1201], or the Welfare and Pension Plans Disclosure Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan, this title, or the Welfare and Pension Plans Disclosure Act.

Put simply, the law makes it unlawful for any person to discriminate against a participant or beneficiary for exercising a right granted (or interfering with the attainment of a right) under ERISA or an ERISA employee benefit plan. In this case, the plaintiff is claiming that the employer reduced her hours of work to below that which the ACA would cause her to be a "full-time employee." In doing so, the defendant avoided the requirement under the ACA to offer her coverage, as well as any the corresponding penalty under Internal Revenue Code Section 4980H if she were a full-time employee. In other words, the essence of the plaintiff's claim is that by reducing her hours of employment, the employer interfered with her attainment of a right under the plan to be eligible to be offered coverage under the medical plan.

So, plan documents say that if you work 30 or more hours per week on average you will be offered coverage, and that by lowering your hours per week, triggering a loss of eligibility for coverage, the employer has impermissibly interfered with your right to eligibility for benefits. Could this be right? Employers have historically modified their workforces in this manner – trimming work hours and consequently eligibility for welfare benefits – as business needs dictated. COBRA, for example, recognizes this ebb and flow of the workplace providing protection for workers who experience a "qualifying event" when they have a reduction in their hours of employment that leads to a loss of coverage under a group health plan. If successful, one effect of plaintiff's argument may be that once an employer hires an employee in an eligible classification under an ERISA plan, that employee has a right under ERISA and the plan to be eligible, and any change by the employer in that classification, or what causes the employee to be in that classification, is an impermissible interference with that right.

ERISA 510 claims, however, are not simple to establish and win. For example, a plaintiff generally must show that the employer acted with a specific intent to violate ERISA §510 in order to interfere with the plaintiff's attaining a right under the plan. This intent can be difficult to prove and, absent direct evidence to the contrary, the defendant may be able to show that its motivation for reducing hours of certain employees was not to interfere with any rights the employees may have had under the medical plan, but was for legitimate, non-discriminatory reasons. In addition, plaintiffs have generally had a difficult time succeeding under ERISA § 510 in regard to welfare benefit plans because of the broad power employers have to amend or terminate benefits under those plans, which typically do not vest like benefits do under retirement plans.

We believe this is the first case in which a court will address this issue and an important case for employers to watch, especially those employers that have taken or are thinking about taking similar steps to address their employer shared responsibility obligations under the ACA.

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NLRB Decisions Challenging Workplace Investigations and Witness Confidentiality

The National Labor Relations Board recently issued two significant decisions reaffirming its earlier determinations, one of which is completely unrelated to whether a labor union is present in the workplace.

In *Banner Estrella Medical Center*, 362 NLRB No. 137 (June 26, 2015), the Board reaffirmed its 2012 decision finding unlawful an employer's request to employees who were involved in a workplace investigation not to discuss the matter with their coworkers while the investigation was ongoing. The NLRB decision requires employers to determine, on a case-by-case basis, whether to request confidentiality. The Board noted four instances in which a request for confidentiality is appropriate – "situations in which 'witnesses need protection, evidence is in danger of being destroyed, testimony is in danger of being fabricated, and there is a need

to prevent a cover-up.'" The Board acknowledged that other situations may exist where a request for confidentiality would be lawful ("we do not exclude the possibility that there may be other comparably serious threats to the integrity of an employer investigation that would be sufficient to justify a confidentiality requirement").

One NLRB Member wrote an extensive dissent to the majority's finding that the nondisclosure request violated the law. He noted that, in this case, a "request" for confidentiality had been made "while this investigation is going on." The dissent argued that, as decided by the administrative law judge, "a narrowly-tailored non-disclosure request like the one at issue here, even if made routinely, [is] lawful under the [National Labor Relations Act]."

In another case involving workplace investigations, an employee's dishonesty during his employer's lawful investigation into workplace complaints could serve as a basis for discipline of the employee, even if the conduct in question took place during the employee's exercise of Section 7 rights under the National Labor Relations Act, the National Labor Relations Board has decided. *Fresenius USA Manufacturing, Inc.*, 362 NLRB No. 130 (June 24, 2015)

The employee, an open and active union supporter, anonymously scribbled vulgar, offensive, and threatening statements on several union newsletters in a company break room to persuade his co-workers to support the union in an upcoming election to "decertify" the Union as the employees' bargaining representative. During an investigation prompted by complaints about the statements by several female employees, the employee denied authorship. After the company confirmed the employee's role, he was suspended and discharged for the statements and his dishonest denial of authorship.

The Board previously had decided the suspension and discharge were unlawful. However, on review, the Board concluded that even assuming that the employee's handwritten statements were protected (the statements encouraged warehouse employees to support the union in the decertification election), the company lawfully discharged the employee for dishonesty. The Board observed that "as part of a full and fair investigation, it may be appropriate for the employer to question an employee about factually-valid claims of harassment and threats, even if that conduct took place during the employee's exercise of Section 7 rights."

In addition, the Board noted the company had a legitimate business interest for investigating the handwritten comments and that its decision to investigate was consistent with its anti-harassment policy and with other federal statutes, including Title VII of the Civil Rights Act of 1964. The company was justified in expecting the employee to answer its questions truthfully. Although the Board noted that in some circumstances an employee may have a legitimate basis for lying to his employer (for example, where an employer unlawfully interrogates an employee about his union organizing activity), this was not such a case.

The Board also concluded the company had conducted its investigation in a manner that was consistent with the purpose of its investigation, the company explained the reason for the investigation, the questioning was reasonably tailored to the purpose of the investigation, the company did not ask about his union views or any of his other union activities, and focused exclusively on the handwritten comments alleged to be harassing and threatening. The Board noted that employers may satisfy their burden by demonstrating dishonesty was an independent reason for termination.

Employers questioning employees in connection with an investigation must have a legitimate business interest and conduct the investigation in a manner consistent with the purpose for the investigation. The questioning should be reasonably tailored to the purpose of the investigation, questioning should be focused on the particular misconduct, and the interviewee should not be asked about other "protected" activities, such as their union views or activities.

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Is Your Health Plan Affordable? If You Offer an Opt-Out Payment, Perhaps Not

An "applicable large employer" is subject to a penalty if either: (1) the employer fails to offer to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) under an eligible employer-sponsored plan and any full-time employee obtains a subsidy for health coverage on a government exchange (Section 4980H(a) liability) or (2) the employer offers

its full-time employees (and their dependents) the opportunity to enroll in MEC under an eligible employer-sponsored plan, but one or more full-time employees obtains a subsidy on an exchange because the employer's coverage was not affordable or does not provide minimum value (Section 4980H(b) liability).

What does "affordable" mean for this purpose? Affordable means that an employee's required contribution for individual coverage under his employer' plan may not exceed 9.5 percent (indexed) of the employee's household income. As employers do not generally have the household income information of their employees, the regulations under Internal Revenue Code Section 4980H provide three separate safe harbors under which an employer may determine affordability based on information that is readily available to the employer – (1) the Form W-2 wages safe harbor, (2) the rate of pay safe harbor, and (3) the federal poverty line safe harbor.

> For example, if an employer uses the Form W-2 safe harbor, health coverage will be deemed to be affordable for Section 4980H(b) liability purposes if an employee's required contribution is no more than $190 per month and his Form W-2 compensation is $2,000 per month ($190 is 9.5% of $2,000).

However, if the employer also offers employees an "opt-out" payment for those who decline coverage, then this opt-out amount must be counted as part of the employee contribution, according to informal discussions with Internal Revenue Service representatives (speaking in their individual rather than official capacities).

> Therefore, using the previous example, if the employer offers employees a $100 per month opt-out payment, the employee contribution amount would be deemed to be $290 per month, rendering the insurance unaffordable under the Form W-2 safe harbor ($290 is 15.5% of $2,000).

While this impact of cash opt-out payments on affordability is not clearly articulated in the Section 4980H regulations, the Internal Revenue Service's informal position described above is consistent with the final regulations relating to the requirement to maintain minimum essential coverage and makes sense from an economic standpoint. We note that the Internal Revenue Service also stated informally that it may treat similar cash payments to Service Contract Act and Davis-Bacon Act employees differently.

If you have analyzed affordability without taking into account any opt-out payments you offer, you should take another look at whether your plan is affordable.

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IRS Makes it Riskier to Maintain Individually-Designed Retirement Plans

The Internal Revenue Service just made it riskier to maintain a tax-qualified individually-designed retirement plan by eliminating the five-year determination letter remedial amendment cycle for these plans, effective January 1, 2017.

Although determination letters are not required for retirement plans to maintain tax-qualified status under the Internal Revenue Code, virtually all employers sponsoring individually-designed retirement plans have long relied on the Internal Revenue Service's favorable determinations that their plans meet the Code's and the IRS' vexingly complex – and ever-changing – technical document requirements. A plan risks losing tax-qualified status (and all the favorable tax treatment that goes along with that status) if the plan document is not timely amended to reflect frequent, sometimes obscure, Code and regulatory changes. In light of that, the IRS has long offered a program for reviewing and approving those plan documents – often conditioning its favorable determination letter on the employer's adoption of one or more corrective technical amendments. The current program, established in 2005, has provided for a five-year remedial amendment cycle which effectively extended the period of time during which a plan could be amended under certain circumstances to retroactively comply with the ever-changing qualification requirements. Under this determination letter program, employers have filed for determination letters for their individually-designed plans every five years and had an opportunity to fix plan document issues raised by the IRS on review.

The IRS announced elimination of the five-year determination letter remedial amendment cycle in Announcement 2015-19 and said that determination letters for individually-designed plans will be limited

to new plans and terminating plans. A transition rule applies for certain plans currently in the five-year cycle (i.e., employers with "Cycle E" or "Cycle A" plans may still file for determination letters) but, effective July 21, 2015, the IRS will not accept off-cycle applications except for new plans and terminating plans.

The IRS said that plan sponsors will be permitted to submit determination letter applications "in certain other limited circumstances that will be determined by Treasury and the IRS" but did not give a hint as to what those circumstances might be. The IRS intends to periodically request comments from the public on what those circumstances ought to be and to then identify those circumstances in future guidance.

In addition, the IRS said that it is "considering ways to make it easier for plan sponsors to comply with the qualified plan document requirements" which might include providing model amendments, not requiring amendments for irrelevant technical changes, or permitting more liberal incorporation by reference.

Comments on the issues raised in the Announcement – e.g., what changes should be made to the standard remedial amendment period rule, what considerations ought to be taken into account regarding interim amendments, and what assistance should be given to plan sponsors wishing to convert to pre-approved plans – may be submitted to the IRS until October 1, 2015.

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Simplifying the Administration of Cafeteria Plan Election Changes

Election change requests are the most rule-centric item encountered in the day-to-day administration of a cafeteria plan. Most cafeteria plans, although not required to do so, allow election changes to the fullest extent permitted by law. But what makes these requests so tedious is the fact that administrators and employees must 'prove the exception' to the general rule that cafeteria plan elections are irrevocable and cannot be modified mid-year.

Usually, employees will request a change to their cafeteria plan election for a "life event" that is fairly straightforward – e.g., marriage, divorce, new child, etc. But for other "change in status" events, the governing IRS regulations can be nuanced with no definitive answer as to whether an election change is permitted. While implementing administrative procedures to help make these determinations is important, the process is incomplete without a general understanding of the change in status rules to fill in the gaps.

The Change in Status Regulations

Although its name sounds like a George Orwell novel, the "life events" described in the Change in Status Regulations are much more mundane. The IRS has identified six categories of change in status events in the regulations. These are: (1) a change in legal marital status; (2) a change in the number of dependents; (3) a change in employment status; (4) when a dependent satisfies or ceases to satisfy dependent eligibility requirements; (5) a change in residence, and; (6) the start or termination of an adoption proceeding (where adoption assistance is provided through the cafeteria plan).

Any event not falling within one of these six event categories cannot serve as the basis for an election change. However, the Change in Status Regulations do not provide a complete list of permissible events within each category. For example, the change in employment status category describes events where the employee, employee's spouse, or the employee's dependent loses or gains eligibility status for the applicable benefit. Terminations, new jobs, leaves of absence, and changes in worksite are all identified as a change in employment status event. But a change in employment event may also occur if a spouse loses coverage due to a reduction of hours or an employee becomes eligible for benefits at a second employer.

An employee walks into HR . . .

From a plan administration perspective, the first consideration should be whether the terms of the cafeteria plan permit a change to the election for the event that occurred. Cafeteria plans are permitted to allow an election change for any of the events covered by the Change in Status Regulations, but are not required to do so. Instead, plan sponsors may restrict the number of event categories or narrow the types of events where an election change is allowed in each category. What the

cafeteria plan cannot do is create additional event categories or have more lenient requirements than the Change in Status Regulations.

The eligibility criteria for the underlying insurance policies and plan documents of the component benefits should also be reviewed. These documents are critical in the determination process because the IRS requires that an election change be consistent with the change in status event (which must have already occurred). Generally, the consistency requirement means the election change must reflect the event. For example, a recently divorced employee's election change request to move from employee-only to family coverage would not be "consistent" with the divorce and the request should be denied.

Administrators should then substantiate the reason for the change in election. This requirement may be satisfied by obtaining an employee's certification that the event occurred and, unless there is reason to believe it did not, no additional follow-up is required.

Once the employee has certified the date of the event, administrators should re-visit the plan document to determine whether the change request is subject to any time requirements. Cafeteria plans normally impose a 30-60 day window for requesting the election change. Plans with extended time limits, or none at all, may find it difficult to satisfy the consistency requirement because there may no longer be a causal connection between the change in status event and election change request.

Additional Considerations

Change in status events are not the only occasions where cafeteria plan participants may be permitted to revoke or modify an election, although they are the most common. Events such as changes to the cost or coverage of a group health plan, HIPAA special enrollment rights, FMLA, COBRA qualifying events, and funding of an HSA with pre-tax contributions all have unique rules and considerations. Some events may allow an election change for one component benefit of the cafeteria plan but not the other (e.g., dependent care FSA vs. health FSA) or affect an employee's ability to make pre-tax contribution.

Even the most detailed procedures and checklists will not exhaust all of the variables administrators must account for when reviewing election change requests. However, using a checklist or similar document will focus your approval determination toward ensuring that a cafeteria plan election change is permitted and meets the IRS's requirements. Unique circumstances are bound to occur within any workforce and a consistent process will aide in the identification of issues that need to be considered further or require the assistance of legal counsel.

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Summer Interns – Might be more costly than you think!

Companies often hire students as Interns during Summer Break or during the school year, but sometimes do not pay them for their work, or pay them less than the federally-mandated minimum wage. While it might seem logical to pay interns less because they don't provide the same skills or productivity as regular employees, failure to pay interns minimum wage and overtime under the Fair Labor Standards Act can lead to stiff penalties if the interns are reclassified as employees. For example, Conde Nast Traveler reached a $5.8 million settlement with a group of 7,500 former summer interns and NBCUniversal settled with a group of interns for $6.4 million.

There is no universal standard for determining if interns are actually "employees" who must be paid for all work time. The Department of Labor uses a six-part test, to wit: (1) the internship is similar to training which would be given in an educational environment; (2) the internship experience is for the benefit of the intern; (3) the intern does not displace regular employees, but instead works under close supervision of regular employees; (4) the company derives no immediate advantage from the activities of the intern and its operations may actually be impeded; (5) the intern is not automatically employed at the conclusion of the internship; and (6) the company and the intern understand that the intern will not be paid for the time spent in the internship.

The DOL's test, however, was recently rejected by the Second Circuit Court of Appeals which reviews cases arising in Connecticut, New York and Vermont. In *Glatt v. Fox Searchlight Pictures, Inc., et al.*, a group of interns urged the Court to adopt a test granting them employee status whenever the employer receives an immediate advantage from

their work. The Department of Labor, in a friend-of-the-court brief in support of the interns, argued that each of the six factors enumerated above must be present for the intern to avoid qualification as an employee. The employers urged the Court to adopt a more flexible test.

Siding with the employers, the Second Circuit adopted the more flexible test and identified seven non-exhaustive criteria, no one of which is dispositive, which must be weighed by any court. Such a flexible standard, the Court said, "reflects a central feature of the modern internship—the relationship between the internship and the intern's formal education."

In light of the Second Circuit's ruling, employers with unpaid internship programs should review those programs in order to determine whether they are in compliance with the minimum wage laws.

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