A Timely Analysis of Legal Developments

ASAP®

In This Issue:

February 2009

The massive $787.2 billion economic recovery package signed into law as the American Recovery and Reinvestment Act of 2009 (ARRA) by President Obama on February 17 will impact employers in several ways. While most of the attention has been focused on the COBRA subsidy provisions, there are several other employment-related provisions in the bill including business tax credits, expanded unemployment benefits, executive compensation limitations, and new restrictions on H-1B visas that employers need to be aware of and plan for.

Beyond COBRA: What Does the Stimulus Package Have for Employers?

By Ellen N. Sueda, GJ Stillson MacDonnell, Patricia A. Haim and Chadwick M. Graham

While most of the media and commentary has been focused on the COBRA subsidy in the American Recovery and Reinvestment Act of 2009 (ARRA or "the Act") signed by President Obama on February 17, there are additional provisions that employers should be aware of including, new tax credits, changes in unemployment benefits, limits on executive compensation and limits on the availability of HB-1 visas. Each of these provisions are discussed in more detail below. For information regarding the COBRA subsidy see Littler's ASAP *The Stimulus Package: An In-Depth Look at the New COBRA Subsidy in the ARRA.*

The Employment Tax Provisions

State Unemployment Insurance

The ARRA provides significant funds to states to expand the amount of unemployment benefits, eligible circumstances qualifying for benefits and the duration of unemployment benefits under the "modernization" provisions of the stimulus law. As a result of these changes, employers are likely to pay higher unemployment insurance taxes and face increasing scrutiny of their utilization of independent contractors as the government enforcement agencies will have more resources to process and audit worker status claims.

Under the terms of the ARRA, the previously expanded 33-week limit for unemployment benefits scheduled to end on March 31 is extended to December 31, 2009. Additionally, the Act increases the current weekly benefits by $25. The law further requires participating state programs that want to maximize receipt of modernization funds to modify eligibility for benefits by choosing two of the four following options:

- Allow individuals to be eligible even if they are only seeking part-time work;
- Allow individuals to be eligible if their employment separation was for compelling family reasons (*i.e.*, domestic violence, family member illness or need to relocate because of spouse's change in job);

- Allow individuals to be eligible if they are participating in a state-approved training program; or
- Increase the allowance for dependents if the state already provides such an allowance.

This increase in benefits coupled with the current high levels of unemployment are likely to result in employers being pushed into the highest unemployment tax brackets for the next three or more years.

From an employee's perspective, unemployment insurance benefits have been taxable income to such recipients for at least federal tax purposes. Under the ARRA, the first $2,500 received will not be subject to federal income taxes during 2009.

For the purposes of calculating benefits and eligibility, states typically use a 12-month "base period" that ends typically three to six months before unemployment begins. For example, if an employee is terminated in February 2009, the "base period" would end September 30, 2008. Under the previous law, upwards of six months of final wages would not generally be considered in setting either benefits or eligibility. As part of the modernization incentives, state laws need to provide either that the base period include the most recently completed calendar quarter before the start of the benefit year or provide that, in the case of an individual who would not otherwise be eligible under state law, eligibility will be determined using the base period that includes the most recently completed calendar quarter.

In addition to potentially requiring state-level legislation to implement these changes, state computer systems and administrative processes will also require modification. This is likely to lead to much confusion in making both eligibility and benefit determinations. Employers will have to remain vigilant to avoid excessive benefit charges.

From the employer's perspective, this shift may increase benefits charged, and therefore, the employer's liabilities under the unemployment system. Additionally, these added modernization funds are likely to fund further state-level staffing resources to audit more actively the status of independent contractors as well as process unemployment claims. It is anticipated that both the enhanced and extended benefits as well as the increased state resources will increase, potentially significantly, the number of misclassification audits conducted by the state agencies. In anticipation of such developments, employers should conduct an internal review of the utilization of independent contractors.

Income Tax Payroll Holiday

Embedded in the law is a special provision known as the "Making Work Pay" credit. It allows for an adjustment of the federal income tax withholding tables to potentially allow single and couples filing jointly (within certain incomes) to reduce the amount of income taxes withheld by up to $400 for singles and $800 for couples in 2009 and 2010. These phased out "credits" are available only to individuals earning $97,000 or less per year or $190,000 for couples.

In order to implement these changes, the IRS will be issuing revised withholding tables that will need to be loaded into an employer's payroll system. As it is anticipated that this process will not be implemented immediately, such tables will be adjusted to reflect prospectively credits retroactive to January 1, 2009. Without such adjustment, the average weekly income tax savings is expected to be $7.69 per week for an individual; with this catch-up provision, it is likely to be between $12 and $14 per week in 2009.

It is anticipated that in addition to adjusting the payroll tables, additional paperwork/worksheets will be required from employees. Employers do not appear to have any choice but to utilize these adjusted tables even though employees have the option to take this credit as part of the filing of their 2009 and 2010 tax returns.

Work Opportunity Tax Credit (WOTC)

The WOTC, a voluntary program by which employers earn a tax credit for hiring individuals from one or more specific groups, is expanded under ARRA. Under the new law, employers are eligible to earn a tax credit for hiring unemployed veterans and disconnected youths after December 31, 2008. A person is considered an unemployed veteran under this Act if he or she has been discharged or released from active duty in the Armed Forces at any time during the five-year period ending on the hiring date, and unemployment compensation benefit under state or federal law for at least four weeks during the one-year period preceding the date of hire. A "disconnected youth"

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

is someone who is between the ages of 16 and 25, is not regularly attending school or employed during the six-month period preceding the hiring date, and is not "readily employable by reason of lacking a sufficient number of basic skills."

Earned Income Tax Credits

Earned Income Tax Credits (EIIC) are temporarily increased for employees with three or more children. To the extent that an employee has provided notice of EIIC eligibility to an employer, the amount of funds provided by an employer under the advance payment system may increase for 2009-2010.

Payroll Taxes and COBRA

The special COBRA subsidy, discussed in detail in Littler's ASAP *The Stimulus Package: An In-Depth Look at the New COBRA Subsidy in the ARRA*, provides that an employer will subsidize 65% of certain insured COBRA premiums. To recover such subsidy, the employer can withhold from its federal income and FICA taxes otherwise collected from employees' wages or owed by an employer from its normal federal tax remittance obligations. If the COBRA premiums exceed the federal payroll taxes owed, a procedure for direct reimbursement by the Treasury is to be provided. Such a credit/offset is not anticipated by any of the current remittance forms, quarterly or annual federal report forms. Likewise, most employer payroll processes are not readily adaptable to comply with this new provision. Major resources from payroll services, employers and the government will be needed to make this work. There is no funding provided for such employer-borne administrative costs.

Qualified Transportation Fringe Benefit Level Increased for Commuters

The law adjusts the pre-tax or subsidized transit pass and vanpool amount for 2009 beginning in March 2009 from the present value of $120 per month to $230 per month. The law does not require that employers make these adjustments nor does it require that any such adjustments be made effective March 1.

While the cap has risen, it is still limited to the lesser of $230 or the actual qualified expenses incurred. Employers are not required to increase their existing subsidies to this level, but they should advise their employees as to their intention before March 1. Existing programs, including withholding authorizations for employees paying for such benefits on a pre-tax basis, should be reviewed to determine whether, if the employer chooses to increase the subsidy level, further authorization must be obtained from participating employees for such adjustments.

As this change nearly doubles previously set determined cap, before increasing the limit, which can be less than the full $230, employers should consider the financial impact on their cashflow. Likewise, employees should consider whether they want to forego further wages, in the case of a pre-tax election. As most companies use an outside service to assist with transit passes, the service should be contacted about making changes as soon as possible to discuss the process and any administrative costs involved.

Government Contractor Withholding Postponed

As part of a 2005 law, government contractors were obliged after 2010 to begin withholding 3% from their payments to subcontractors for goods and services and remit this to the IRS as a pre-payment of income taxes owed by such contractors. The original law was designed to both accelerate income tax payments to the federal government as well as to make sure that at least some minimum income taxes were received on such income. This law was highly controversial at the time enacted, and significant efforts have been undertaken to repeal or delay its implementation. The ARRA has now delayed the effective date of this provision for an additional year.

Executive Compensation Limitations

As the economy continues to falter and the public becomes impatient with the lack of progress from the initial government stimulus this past Fall, much of the general reaction to the earlier legislation providing government aid to failing companies was that it was not sufficiently stringent on executive compensation. It is, therefore, not a surprise that any new executive compensation legislation

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

for companies seeking government aid would result in tougher laws. In response to the public's disapproval of current compensation legislation for troubled companies, Congress passed Title VII of the ARRA, which amends and replaces the corporate governance and executive compensation requirements of the Troubled Asset Relief Program (TARP), a program originally created under Section 111 of the Emergency Economic Stabilization Act of 2008 (EESA).

Prior to the ARRA, the Treasury Department created a means for the government to aid companies in financial trouble by delineating the following three programs from TARP through interim guidance under EESA: the Capital Purchase Program (CPP), the Program for Systemically Significant Failing Institutions (PSSFI), and the Troubled Assets Auction Program (TAAP). However, on January 20, 2009, Rahm Emanuel, President Obama's Chief of Staff, issued a memorandum that halted the issuance of further guidance from all governmental agencies until each program could be reviewed and approved by the department or agency heads that were appointed or designated by the Obama administration. As such, no final guidance has been issued for any of the TARP programs, and the Secretary of the Treasury Department (the "Secretary") has been tasked with providing guidance and standards, consistent with the ARRA, for the recipients of TARP funding, as well as with the authority to enforce such standards.

As Title VII of the ARRA will replace Section 111 of EESA in its entirety, the synopsis below explains the changes in the law. In this article, "ARRA" refers to the newly amended executive compensation rules under the Emergency Economic Stabilization Act of 2008 and "EESA" refers to the executive compensation rules under the Emergency Economic Stabilization Act of 2008 prior to amendment by the ARRA.

General Provisions

During its period of applicability, EESA applied to any TARP participant in which the Treasury Department held an equity or debt position, including warrants or equity acquired under a warrant.[1] Unlike EESA, the ARRA does not apply if the federal government holds only warrants to purchase common stock of the TARP participants. The ARRA applies to a TARP participant only during the period in which any obligation arising from TARP assistance, except warrants to purchase common stock remains outstanding,(the "TARP Recipient"). The rules under the ARRA appear to apply to both past and future TARP Recipients, as currently there is no stated effective date of the ARRA's amendments to EESA. However, a prior TARP participant may repay the TARP funds received, subject to consultation with an appropriate federal banking agency, in order to avoid the application of the ARRA's executive compensation provisions.

In addition, the Secretary has the authority under the ARRA to review bonuses, retention awards and other compensation paid to senior executive officers (SEOs) and the next 20 most highly compensated employees[2] of TARP Recipients prior to the date of the enactment of the ARRA. The Secretary will determine if any of those payments were inconsistent with the purpose of the ARRA, TARP or in contravention to the public interest. If the Secretary determines that the TARP Recipient should not have made those payments, then the Secretary will negotiate with the company and the affected employee(s) for reimbursement.

Standards for Executive Compensation

The standards for executive compensation generally apply to the TARP Recipients' SEOs, except as specifically provided below. An SEO is defined as an individual who is one of the top five most highly paid executives of a publicly traded company, whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1934 and its regulations (generally the company's named executive officers whose compensation is disclosed on the proxy), and non-public companies' counterparts. The definition of SEO under EESA and the ARRA is generally the same.[3]

Similar to EESA, the ARRA includes:

- Limits on compensation that require the exclusion of incentives that encourage executives to take unnecessary and excessive risks that threaten the value of the TARP Recipient. Under the ARRA, this rule applies to SEOs and other employees, whereas EESA applied it only to SEOs.

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

- Recovery by the TARP Recipient of any bonus, retention award, or incentive compensation that was paid based on certain financial statements that are later found to be materially inaccurate. Under the ARRA, this rule applies to SEOs and all of the next 20 most highly compensated employees, whereas this rule under EESA applied only to SEOs.

Unlike EESA, the ARRA prohibits a TARP Recipient from paying or accruing any bonus, retention award or incentive compensation, except for (1) long-term restricted stock that does not vest during the time that the company is a TARP Recipient, has a value in the amount that is not greater than 1/3 of the total amount of the employee's annual compensation,[4] and other terms and conditions that the Secretary may determine; and (2) bonus payments required to be made pursuant to a written employment contract executed on or before February 11, 2009 (the validity of which is subject to the Secretary's determination). These limitations apply on a sliding scale to a TARP Recipient's employees depending upon the amount of financial assistance received.

Amount of Financial Assistance Received	Employees to Which Prohibition Applies
Less than $25,000,000	The most highly compensated employee
Equal to or greater than $25,000,000, but less than $250,000,000	The five most highly compensated employees (or a greater number as the Secretary determines)
Equal to or greater than $250,000,000, but less than $500,000,000	The SEOs and 10 next most highly compensated employees (or a greater number as the Secretary determines)
Equal or greater than $500,000,000	The SEOs and 20 next most highly compensated employees (or a greater number as the Secretary determines)

The ARRA also broadly refers to limits on compensation, but it does not specifically incorporate the limits set forth in the remarks made by President Obama on executive compensation on February 4, 2009. Treasury Department guidelines issued in connection with President Obama's remarks (the "Guidelines") limit pay at $500,000 for executives, except for restricted stock grants described above. Similar to the PSSFI and CPP, the Guidelines delineate two types of programs recognized under its guidelines: the Exceptional Financial Recovery Assistance Program (EFRAP), which includes companies such as Citigroup and AIG, and the Generally Available Capital Access Program (GACAP). TARP Recipients participating in GACAP may waive the $500,000 limit on executive compensation and restricted stock by disclosing the amount of its executive's compensation and requesting a non-binding "say-on-pay" by shareholders.

Similar to EESA, the ARRA prohibits TARP Recipients from making severance payments. EESA provided a limit on "parachute payments" of no more than three times an SEO's average annual compensation (calculated based on a five-year average). Whereas the limit on severance payments under EESA was only on payments made upon involuntary termination or termination in connection with any bankruptcy, liquidation, or receivership of the employer, the limit on severance payments under the ARRA applies to any payment to an SEO made due to his or her departure from the company for any reason, unless the payment is made for services performed or benefits accrued. In addition, this rule applies to an SEO and any of the next five most highly compensated employees.

Finally, the ARRA also prohibits any compensation that would encourage the manipulation of reported earnings of the TARP Recipient, thus resulting in the enhancement of the compensation of its employees.

Limitation on Deductibility of Executive Compensation

The limitation on the deduction of a TARP Recipient's covered executive's compensation is $500,000 per SEO. However, unlike the rules under EESA, the ARRA limitation will apply to all TARP Recipients, not just TARP Recipients in which the federal government owns a minimum amount of troubled assets.

Limitation on Luxury Expenditures

The TARP Recipient's board of directors must adopt a company-wide policy regarding excessive or luxury expenditures (as the Secretary determines), which may include expenditures on the following:

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

- Entertainment or events;
- Office and facility renovations;
- Aviation or other transportation services; or
- Other activities or events that are not reasonable expenditures for staff development, reasonable performance incentives, or other similar measures conducted in the normal course of the TARP Recipient's business operations.

Corporate Governance

Similar to the interim guidance that the Treasury Department issued relating to the CPP, the TARP Recipient's CEO and CFO (or equivalent officer) are required to provide written certification of compliance with the ARRA. If the TARP Recipient is a public company, then the certification is to be provided to the Securities and Exchange Commission (SEC), as well as in the annual filings. If the TARP Recipient is a private company, then the certification is to be provided to the Secretary. Unlike the interim guidance, the ARRA does not appear to require the compensation committee to certify that it has complied with the terms and conditions of the ARRA. The compensation committee certification may become a regulatory requirement.

The ARRA requires that a TARP Recipient establish a "Board Compensation Committee" comprised solely of independent directors. Most public companies that are subject to the deduction limitations of Section 162(m) of the Internal Revenue Code and that provide performance-based compensation to their executives already have a compensation committee that consist of independent directors.[5] The Board Compensation Committee for companies that are not subject to the Securities Exchange Act of 1934 and received $25,000,000 or less of financial assistance will be that company's entire board of directors. The Board Compensation Committee must meet at least twice a year to assess, discuss and evaluate employee compensation plans and associated risks.

Any proxy, consent or authorization for an annual shareholder meeting, or any other shareholder meeting, of TARP Recipients must allow shareholders to vote on the approval of executive compensation disclosed in the TARP Recipients' SEC filings. The vote will not: (1) be construed as overriding the board of director's decision regarding executive compensation, (2) create or imply any additional fiduciary duties of the board of directors; or (3) restrict or limit the shareholders to make proposals relating to executive compensation. The vote will be nonbinding on the TARP Recipients' board of directors. In other words, shareholders would have an advisory vote on the executive compensation packages of TARP Recipients. This legislation is similar to "say-on-pay" shareholder proposals that are aimed at giving shareholders an advisory vote on executive compensation. Say-on-pay proposals gained momentum over the past three years, but they appeared to be losing steam recently, as most say-on-pay proposals that were put to a vote in 2008 were rejected by shareholders.

What Employers Should Consider in Light of the ARRA

Although the ARRA imposes restrictions and guidelines for TARP Recipients on executive compensation, those rules may have a far-reaching effect on companies that are not TARP Recipients. In addition to the rules for TARP Recipients, the Guidelines encourage the implementation of compensation systems that create long-term value for both the company and its shareholders, significant equity ownership periods for executives, and non-binding "say-on-pay" shareholder resolutions.

In anticipation of the new standards stemming from the ARRA and the Guidelines, companies that are not TARP Recipients should consider reviewing and eliminating what shareholders perceive as "luxury expenditures," initiating stock ownership guidelines for executives with significant holding periods, and implementing nonbinding shareholder "say-on-pay" proposals.

Immigration-Related Provisions of the ARRA

H-1B Visa Program Amendments

The stimulus package includes a number of immigration-related provisions. Perhaps the most controversial is the amendment

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

introduced by Senator Bernie Sanders (I - Vermont), which severely limits the ability of employers receiving bail-out funds to sponsor H-1B employees. The H-1B visa program is the primary method available to U.S. employers that enables them to hire foreign national professionals or "specialty workers" to work in the United States on a temporary basis.

Under the Sanders Amendment, companies that receive stimulus money from TARP or that participate in certain federal loans may not sponsor new H-1B employees for a two-year period unless they can demonstrate that they have first made good faith efforts to recruit U.S. workers for the position. This amendment expands to all employers that receive TARP bail-out funds the requirements that currently are limited to "H-1B dependent" employers, who must make additional recruitment efforts and attest to the nondisplacement of U.S. workers whenever they file an H-1B petition.

This portion of the stimulus package is expected to place a heavy burden on a number of larger U.S. employers, perhaps most prominently among financial institutions and automakers, and it may make it more difficult for them to attract and retain highly qualified, specialized foreign workers.

E-Verify Amendment

The good news from an immigration standpoint is that the E-Verify amendment proposed by Congressman Jack Kingston (R – GA) was eliminated from the final version of the stimulus bill. The amendment was another attempt to require force the E-Verify program on more employers by requiring any federal contractor hired under the authority of the stimulus bill to verify the employment eligibility of workers through E-Verify.

Business groups have taken the position that while the verification of U.S. employment authorization is a laudable goal, putting this immigration enforcement burden on employers in this way creates additional delays and complications in hiring, which is especially counterproductive in this ailing economy.

There are signs that the federal government may be moving away from E-Verify. The removal of the E-Verify amendment from the current stimulus bill comes on the heels of the Obama Administration's postponement of the effective date of the federal contractor E-Verify regulation until May 21st of this year. See Littler's ASAP, *Effective Date of Federal Contractor E-Verify Regulation Pushed Back to May 2009*. While E-Verify will probably continue to exist at least into the near future, many businesses will be relieved to see that its influence is being limited.

Unemployment Benefits for Non-Citizens or Permanent Residents

Under Section 1853 of the stimulus package, workers receiving unemployment benefits who are not U.S. citizens or permanent residents will be required to have their immigration status re-verified if the initial documentation that they provided expires at any time while they are receiving unemployment benefits. The purpose of this provision is to ensure that unemployment benefits will go only people who are eligible to work legally in the U.S.

Other Immigration Provisions

It is also worth noting that this package bill prohibits the issuance of a stimulus loan to any company that the Secretary of Homeland Security or Attorney General have determined engaged in a pattern or practice of hiring or recruiting unauthorized workers.

Ellen N. Sueda is a Shareholder in Littler Mendelson's San Francisco office and focuses her practice on Executive Compensation issues. GJ Stillson MacDonnell is a shareholder and chair of Littler Mendelson's Employment Taxes Practice Group in Littler's San Francisco office. Patricia A. Haim is a Shareholder in Littler Mendelson's Portland office Chadwick M. Graham is an Associate in Littler Mendelson's Phoenix office. Both Ms. Haim and Mr. Graham focus their area of practice on Immigration issues. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Ms. Sueda at esueda@littler.com, Ms. MacDonnell at gjmacdonnell@littler.com, Ms. Haim at phaim@littler.com, or Mr. Graham at cgraham@littler.com.

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.

[1] Note that EESA provided a method of relief by which troubled assets could have been auctioned off by the participating company, but it appears that the auction sale concept has been abandoned as an avenue for relief.

[2] ARRA does not provide the manner in which a highly-compensated employee will be defined. Section 409A of the Internal Revenue Code provides rules regarding the determination of certain highly compensated officers of a publicly traded company and the guidance under ARRA may be similar.

[3] The FAQs issued in connection with EESA provided that the determination of whether an employee is an SEO was dependent upon the applicable provision. For example, the SEOs for purposes of the deduction limitation may be different than the SEOs for purposes of determining the severance limitation. We anticipate that the rules will be the same for ARRA.

[4] The rule regarding restricted stock grants does not indicate whether the limitation applies to annual grants or aggregate grants over the period, which the company is a TARP Recipient.

[5] It will be interesting to see if the Treasury Department provides that the “independent” requirement is defined under the standards of Section 162(m) or the less restrictive definition under federal securities laws.

ASAP® is published by Littler Mendelson in order to review the latest developments in employment law. ASAP® is designed to provide accurate and informative information and should not be considered legal advice.