Cross-Border Benefits

Insights
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Foreign companies with U.S. operations should be aware of the compliance requirements imposed by employee benefit laws (including federal tax laws and the Employee Retirement Income Security Act of 1974, or ERISA) in order to avoid the risks and liabilities that can arise either from litigation brought by employees, or as a result of government enforcement that could lead to excise taxes and penalties.

The IRS and the U.S. Department of Labor are the governmental agencies charged with responsibility for the enforcement of employee benefit plan rules. As the value of the U.S. dollar remains low against many other currencies, many foreign corporations and investors are buying U.S. businesses. When a foreign multinational company acquires a U.S. business operation, the foreign ownership itself can create problems that may not have existed before with respect to a number of compliance issues, some of which are addressed below.

Issues With Controlled Groups

Many employee benefit plans that are maintained for employees in the U.S. are subject to a variety of rules that are intended to prevent discrimination in favor of "highly compensated employees." These rules generally apply to pension plans, 401(k) plans, cafeteria plans and self-insured health plans. Current regulations impose tests related to "coverage" (i.e., who participates or who is eligible to participate in a plan) as well as the level of benefit contributions or availability of the benefits, rights or features of a plan. The tests are designed to keep the benefits of highly compensated employees within a determined proportion to those provided to the non-highly compensated employees.

These discrimination tests can be of particular concern for foreign-owned business operations because of the application of certain "controlled group" rules. Under these rules, the U.S. business operations of a foreign-owned entity will generally be required to be treated as though they were all part of a single employer. For example, if a French parent company owns two otherwise entirely unrelated corporate subsidiaries with U.S. business operations, the employees of these two corporations would all be treated as employed by a single employer. If only one of these corporations sponsors a 401(k) plan, the participation or coverage of that plan may, after application of the appropriate discrimination testing rules, be discriminatory, and therefore not qualified for the favorable tax treatment ordinarily afforded a 401(k) plan. This may occur even if the plan might have passed the discrimination test as a stand-alone plan.

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This can very easily be the case where the mix of highly-compensated employees (generally, employees who make more than $110,000 per year) and non-highly-compensated employees is very different in the two U.S. operations. Experience has shown that this type of situation is frequently discovered after years of non-compliance that resulted from an acquisition of a U.S. business by a foreign multi-national corporation. Usually the U.S. business continued in operation after the acquisition without much change and without the U.S. management fully understanding the implications of that business within a larger group of businesses all under the common control of the new multi-national corporate owner.

Similar concerns can arise with respect to the testing of employee benefit plans for discrimination as to availability of benefits, rights or features where the tests may be passed on an individual corporate basis, but not on a controlled group basis.

Vesting Concerns

Compliance with applicable federal tax laws and ERISA also requires that certain minimum eligibility and "vesting" requirements be satisfied. These requirements can also be affected by the inclusion of a business in a controlled group. For example, an employee's prior employment with another business that was part of the controlled group with his or her new employer may be improperly disregarded, particularly where the management of the new employer is not aware of the existence of the members of the controlled group.

The Problem With Prototypes

The plan documentation that sets the terms and conditions that govern the operation of an employee benefit plan often includes standard provisions about other members of the plan sponsor's controlled group. Sometimes, "prototype" plan documents, which are provided by financial institutions for the purpose of adopting benefit plans, may include language that makes all employees of all businesses of the controlled group eligible to participate.

Among other things, prototype plan documents provide the plan sponsor or employer with a menu of options concerning who is eligible to participate, the level of benefits to be provided and what other related employers will be covered under the plan. If such a plan is used initially by a U.S. corporation, which is later acquired by a multi-national corporate parent, the continued use of that plan document can result in the inclusion of employees of other members of the controlled group under the terms of the governing plan document itself. This typically results in a failure in the operation of the plan when those employees are not, in fact, included in the plan.

As an example of how the failure can impact the plan sponsor and parent, consider a situation where a foreign company with thousands of employees in India and Asia acquires a U.S. subsidiary with relatively few, but comparatively highly paid, employees. This U.S. Company sponsors a 401(k) plan for its employees utilizing a prototype plan document. When adopted, the company did not choose to exclude "non-resident aliens" from coverage. At the time, this didn't create a problem because the U.S. company was not a member of a controlled group and did not have any non-resident alien employees.

But if the documents are not amended, after the acquisition, the employees of the foreign parent in Asia and India, are suddenly covered by the 401(k) plan based on its failure to exclude non-resident alien employees. Over time, this could lead to litigation for benefits brought by the non-resident employees or to other liabilities imposed by a government enforcement action. These liabilities could be avoided by simply amending the plan documentation to exclude non-resident aliens.

COBRA Considerations

Other areas of potential concern can include failure to comply with the requirements of the federal health insurance continuation laws, often referred to as COBRA. Since these rules also pick up the controlled-group rules, a multi-national corporation that shuts down a U.S. business operation may unwittingly be exposed to enormous potential liability from a failure to offer continuation of health insurance coverage to the employees of the business that was closed.

While a single business operation that shuts down entirely generally will not have an obligation to provide for continuation of health coverage for its terminated employees, when an employer that is part of a controlled group is shut down, if any other member of the group continues to offer a group health plan, a member of the controlled group usually must offer continuation of health coverage to the employees terminated in the business that shut down – even if those employees were never previously eligible to participate in that other business' group health plan.

The failure to realize that this obligation exists is obviously a problem, but these rules can be troublesome even if recognized in a timely manner. If the insurance carrier for the other controlled group member's plan refuses to cover the terminated employees under COBRA because the terms of its contract only provide for continuation coverage for individuals who were already covered under that particular group policy, the resources to pay for benefits may not be available.

Our Advice

It's important to conduct U.S. business operations with close attention to the requirements of U.S. tax and employment laws, including the controlled-group rules and their implications. It's possible to operate U.S. business operations with minimal risk in this area but plan sponsors and foreign parents need to be aware of the overall structure of these rules and their application to a controlled group of businesses. Clearly attention to the details of the benefits offered and the particular provisions of the governing plan documents is both necessary and important.

If you are an employer who is related to a foreign company, you should carefully review the governing documents of your employee benefit plans to ensure that the plan only covers those employees who are actually intended to be covered, and verify that the application of the ERISA controlled-group rules has been addressed. The language in adoption agreements to prototype plans can often lead to unintended benefit obligations as well as to the loss of the plan's tax-exempt status.

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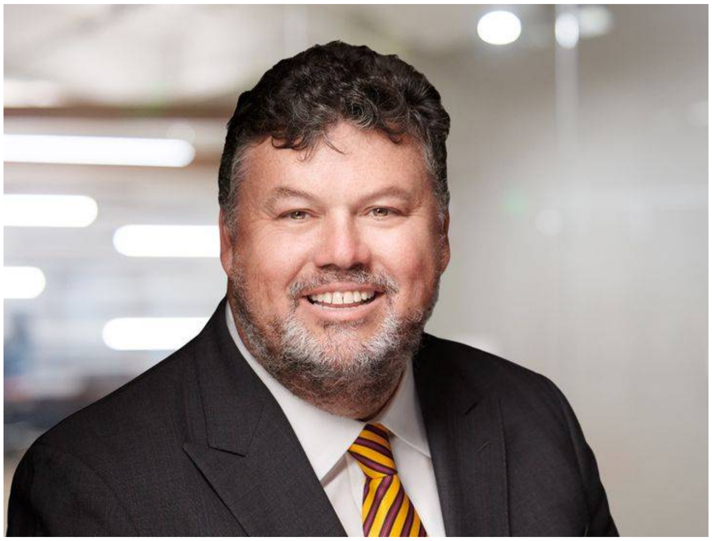

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