EMPLOYEE BENEFITS

TAX REFORM: THE FIVE BIG CHANGES AFFECTING EMPLOYEE BENEFITS

By Eric Gregory

On December 22, 2017, President Trump signed H.R. 1 (formerly, the "Tax Cuts and Jobs Act" (the "Act")) into law. While the Act was primarily focused on business tax cuts and individual tax reform, the Act includes several provisions that have implications for employee benefits and executive compensation.

1. Compensation Deduction Limits for Publicly Traded Employers

Prior Law

Under Code Section 162(m), publicly held corporations are limited to a $1 million cap on the deductibility of compensation paid to a single "covered employee." Prior to the Act, "covered employees" included the CEO and the three highest paid officers. Additionally, there was an exception that generally allowed compensation to be deductible (without regard to the $1 million cap) if it was "performance-based compensation," based on performance goals set by a compensation committee with shareholder approval.

Changes in the Act

The Act repeals the performance-based compensation exception, and expands the definition of covered employees to include the CEO, CFO, and three highest paid employees. Additionally, once an employee qualifies as a covered employee, the deduction limitation applies so long as that employee or any beneficiary is being paid by the corporation. The Act also expands the definition of "publicly traded corporation" to include all companies that file SEC reports.

Implications and Action Steps

The Act's changes for the compensation deduction limits go into effect for taxable years beginning after December 31, 2017. However, the revisions do not apply to payments made pursuant to a written, binding contract between a company and a covered employee that was in effect on November 2, 2017, provided the contract is not modified in a material way on or after that date.

Employers should consider whether any existing documents might fit into the transition rule, and should determine whether any bonuses payable in 2018 might be accelerated into 2017 pursuant to IRS guidance regarding accruals.

2. Excise Tax on Tax-Exempt Organization Compensation

The Act imposes a new 21% excise tax on compensation that exceeds $1 million paid to a tax-exempt employer's five highest paid employees (including any former employees who would have been covered by this definition for any year after December 31, 2016). It applies to both direct and indirect compensation. It also applies to any "parachute payment," where the aggregate payment is three times (or more) the average compensation in the preceding five years.

Implications and Action Steps

The new excise tax is effective for tax years after December 31, 2017. There is no transition rule for applying the excise tax on compensation paid to the employees. Exempt organizations will need to identify their highest five-paid employees based on the 2017 tax year, who will be considered covered employees for 2018.

3. Tax Deferral for Certain Equity Grants from Private Companies

The Act allows privately held employers to provide a new tax-deferred benefit to certain employees. "Qualified employees" may elect to defer tax on certain equity grants for up to five years. The election to defer must be made within 30 days after the employee's right to the stock has become vested, and applies to "qualified stock" issued pursuant to stock option exercises or settlement of restricted stock units after December 31, 2017.

The awards must be offered with the same terms to no less than 80% of the company's employees providing services in the United States. The employer must provide notice to the employees about the right to defer.

"Qualified employees" are employees excluding the company's CEO, CFO, any person who has ever served in that capacity, family members of the aforementioned, 1% owners (and those that have been 1% owners in the past 10 tax years), and anyone who has been one of the four highest paid officers in the past 10 tax years.

Implications and Action Steps

Until regulations are issued specifying additional details with respect to the 80% rule and notice requirements, a company will be treated as in compliance with the Act so long as it demonstrates a reasonable, good faith interpretation of the Act.

It is unclear how valuable this benefit will be to employers, given the 80% requirement as well as the requirement that employees recognize income within five years of vesting, even if no liquidity event has occurred prior to that date.

4. Qualified Retirement Plan Loans

Truly, the biggest news about the Act with respect to qualified retirement plans was what the Act did not include. Early reports suggested that the Act would impose limitations on the amount of pre-tax contributions to qualified retirement plans. The Act does not make such changes.

However, the Act does include a provision that would allow those who leave their current employer with an outstanding loan from their qualified retirement plan to not be taxed on that loan amount if they contribute that loan balance to an IRA by the date their individual tax return is due.

Implications and Action Steps

This will be seen as a valued benefit for many employees, as it is difficult for employees to arrange for repayment of a plan loan after termination.

5. New Limitations on Fringe Benefits

A number of different fringe benefits are affected by changes in the Act. These include:

• Excluding from the definition of excludable employee achievement awards anything that is not tangible personal property (e.g., cash, cash equivalents, gift cards, meals, lodging or tickets);
• A denial of the employer deduction for the expense of providing qualified transportation fringe or reimbursements to an employee in connection with commuting; and
• A suspension of the exclusion from gross income for employer-provided qualified moving expense reimbursements and the deduction by an individual of moving expenses incurred when starting a new job from 2018 through 2025.

Implications and Action Steps

All of the fringe benefit changes go into effect for tax years after December 31, 2017.

With respect to employee achievement awards, the Conference Report for the Act suggests that this is not intended to be understood as a change from existing law, and merely represents a codification of the IRS' existing enforcement position.

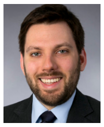
The changes to qualified transportation fringe eliminate the employer deduction but retain the exclusion. For many employers it would now be more efficient to pay deductible wages subject to payroll taxes than to provide an excludable benefit that is taxable to the employer.

With respect to qualified moving expenses, employers may need to consider grossing-up the expenses of employees who are being asked to move for a new position, as they may be expecting a tax-free incentive to relocate.

Conclusion

There are many year-end planning and compliance steps to be considered by employers in the very short time window prior to the New Year. Please contact any member of the Dickinson Wright employee benefits practice team if you have any questions about these new rules or how to prepare for their implementation.

FOR MORE INFORMATION CONTACT:



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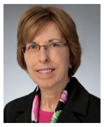

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