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Client Alert

Employee Benefit Changes in the Tax Cuts and Jobs Act of 2017

On December 22, 2017, President Trump signed what is popularly known as the Tax Cuts and Jobs Act (H.R. 1) (the "Bill"), overhauling America's tax code for both individuals and corporations and providing the most sweeping changes to the U.S. Tax Code since 1986. The House and Senate Conference Committee provided a Policy Highlights of the major provisions of the Bill, and the Joint Committee on Taxation provided a lengthy explanation of the Bill.

Compared to initial proposals, the final Bill generally does not make significant changes to employee benefits. The chart that follows highlights certain broad-based health and welfare, fringe and retirement plan benefit provisions of the Bill (comparing them to current law). Notable changes include:

- Repeal of the Individual Mandate penalty beginning in 2019;
- Elimination/changes of employer deductions for certain fringe benefits, including qualified transportation fringes, moving expenses, and meals/entertainment;
- New tax credit for employers that pay qualifying employee while on family and medical leave, as described by the Family Medical Leave Act;
- Extended rollover periods for deemed distributions of retirement plan loans; and
- Tax relief for retirement plan distributions to relieve 2016 major disasters.

In addition, the Bill makes certain narrowly-tailored changes (which we did not include in the chart that follows) impacting only certain types of employers or compensation. For instance, the Bill:

- modifies the $1 million compensation deduction limitation under Code Section 162(m) for publicly traded companies (expanding the type of compensation which will be applied against the limitation, the individuals who will be considered covered employees, and the type of employers that will be subject to the limitation), with transition relief for certain performance-based compensation arrangements pursuant to "written binding contracts" in effect as of November 2, 2017, so long as such arrangements are not "modified in any material respect"; and
- creates a new "qualified equity grant" by adding a new Code Section 83(i), which allows employees of non-publicly traded companies to elect to defer taxation of stock options and restricted stock units ("RSUs") for up to five years after the exercise of such stock options or the vesting of RSUs.

The Bill also has specific provisions impacting employers that are tax-exempt organizations. For instance, it imposes a new excise tax for highly compensated non-profit employees, and changes the way non-profits calculate unrelated business income tax (UBIT).

What's Not Changing

ACA Employer Mandate & Reporting

While the individual mandate penalty has been reduced to zero beginning in 2019, at this time, **the employer mandate and employer reporting requirements under the Affordable Care Act (ACA) remain in effect**.

In addition, there were **no** changes to other ACA taxes and requirements. For example, the bill does **not** eliminate (or delay) the 40% excise tax on high-cost plans (Cadillac Tax) that is scheduled to be effective beginning in 2020, nor does it eliminate the comparative effectiveness research fees paid annually to fund the Patient-Centered Outcomes Research Institute (PCORI) through 2019. However, the Trump Administration has indicated its intention to renew ACA repeal and replace efforts in 2018, which may result in additional changes at a later date.

It has been recently reported that Republican legislators are targeting a further delay of two ACA-created taxes – a 2.3% excise tax on medical devices, and an annual fee imposed on health insurers known as the HIT tax – for inclusion in a spending bill that must be passed by January 19. Both of these taxes are scheduled to go into effect beginning in 2018 after a delay was incorporated in a 2015 year-end tax extenders deal. Employer groups have been lobbying for an elimination or delay of the Cadillac Tax and relief on the employer mandate. It remains to be seen whether these tax relief items will be included as part of a spending bill later this month.

FSAs, HSAs, Adoption Assistance and Education Assistance Programs

Earlier versions of the Bill in both the House and Senate included provisions that would have significantly impacted the tax treatment of many employee benefits. However, the final Bill makes **no** changes to the tax treatment of HSAs, dependent care FSAs, health FSAs, adoption assistance programs, or qualified education assistance programs. Although, it has been reported that repealing restrictions on using FSAs, HSAs and other account-based plans to purchase over-the-counter medications could also be considered during negotiation of the spending bill.

Unsubsidized/Pre-Tax Qualified Transportation Fringe Benefits

While the Bill eliminated the employer deduction for qualified transportation fringe benefits, this change would appear to have the most impact on employers who ***subsidize*** transit and parking expenses since they may no longer claim a deduction for subsidized transit expenses (but such amounts would still be exempt for payroll tax purposes). For the majority of employers who do not subsidize transit expenses but offer pre-tax qualified transportation fringe programs that allow employees to enter into salary reduction agreements and receive transit expense reimbursements on a tax-free basis, the Bill should not have an impact on those programs. Tax-exempt employers will be taxed on the value of providing qualified transportation fringe benefits (such as payments for mass transit) by treating the funds used to pay for the benefits as UBIT.

For the majority of employers who do not subsidize transit expenses but offer pre-tax qualified transportation fringe programs that allow employees to enter into salary reduction agreements and receive transit expense reimbursements on a tax-free basis, the Bill should not have an impact on those programs. Employees may continue to receive transit expenses (other than bicycle commuting expenses) on a tax-free basis under such programs.

Structural Changes to Qualified Retirement Plans and Deferred Compensation Plans

In addition, there were no major changes to the general structure of qualified retirement plans, such as the "Rothification" of pre-tax deferrals in 401(k) plans, nor reductions in the limits that could be contributed tax-free. Nor were other changes that were initially proposed in the House version of the bill to retirement provisions (e.g., changing the minimum age of in-service distribution in retirement plans, modifying non-discrimination rules for "soft-frozen" defined benefit plans, and changes to 401(k) and 403(b) hardship withdrawal rules) included in the final bill.

Earlier versions of the Bill would have also completely upended how deferred compensation by companies to executives is paid by taxing such compensation when it vested. But this provision did not survive in the final Bill.

Next Steps

Only time will tell the full impact of the Bill on employers and employees. For instance, the repeal of the individual mandate beginning in 2019 may result in fewer "healthy" individuals enrolling in health coverage, resulting in increased premiums. Fewer individuals may enroll in Exchange coverage, reducing potential employer mandate penalty (both "A" and "B") exposure, which is triggered when a full-time employee receives a premium subsidy for Exchange coverage.

Given the changes to the corporate tax rates, it remains to be seen whether employers will alter how they compensate their employees, particularly, highly compensated employees, and how they will handle their pension, 401(k)/profit sharing plans, and other employee benefits.

In addition, it is likely that there will be a correction bill (and IRS guidance) in 2018 to address unintended consequences, omissions, ambiguities, and drafting errors in the Bill. We will continue to monitor for further legislative and other developments impacting employee benefits as a result of the passage of the Bill.

In the meantime, we suggest that employers work with their payroll departments and vendors, accountants, finance, counsel and other advisors to assess the impact of the Bill to its benefit programs and implement necessary changes to their systems and practices.

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SUMMARY OF SELECT EMPLOYEE BENEFITS CHANGES IN THE TAX CUTS AND JOBS ACT (H.R. 1)[1]

Provision (Code Section)	Current Law	New Law (Bill Section)
HEALTH & WELFARE BENEFITS		
Individual Health Insurance Mandate (Code Section 5000A)	The Affordable Care Act imposes a tax penalty on individuals for any calendar month in which they are not covered by health insurance providing "minimum essential coverage." For 2018, the annual individual mandate penalty amount per adult is $695 or 2.5% of household income in excess of tax filing thresholds, whichever is higher.	The individual mandate penalty is reduced to **zero**. *Effective Date: Beginning January 1, 2019* (Section 11081)
Medical Expense Deduction Threshold (Code Section 213)	Individuals are allowed a deduction for unreimbursed medical care expenses to the extent that they expenses exceed 10% of AGI.	The medical expense deduction would be **reduced** to allow a deduction for unreimbursed medical care expenses that exceed 7.5% of AGI for **all** taxpayers. *Effective Date: 2017 and 2018 only* (thereafter, the provision would sunset and the limit would return to 10% of AGI for all taxpayers) (Section 11027)

[1] This summary is not an exhaustive list of all changes in the Tax Cuts and Jobs Act (H.R. 1). It only covers select employee benefit changes. It is provided for educational and informational purposes only and does not contain legal advice. You should not act on any information provided without consulting legal counsel.

Provision (Code Section)	Current Law	New Law (Bill Section)
HEALTH & WELFARE BENEFITS		
Employer Credit for Paid Family and Medical Leave (No Current Code Section; Bill creates new Code Section 45S)	The Family and Medical Leave Act (FMLA) entitles certain employees of covered employers to take twelve weeks of unpaid, job-protected leave annually for specified family and medical reasons (e.g., the birth of a child, to care for an employee's spouse, child, or parent who has a serious health condition, or for a serious health condition that makes the employee unable to perform the essential functions of his or her job). No current law allows employers to claim a credit for compensation paid to employee on family and medical leave.	New general business tax credit for employers that pay employees on family and medical leave, as described by the FMLA. An employer must allow all "qualifying" full-time employees not less than two weeks of annual paid family and medical leave (and a commensurate amount of leave on a pro rata basis for less-than-full-time employees). The leave program must provide for at least 50% of the wages normally paid to an employee. Vacation leave, personal leave, or other medical or sick leave would not be considered family and medical leave. Leave paid for or mandated by a state or local government is **not** taken into account. A "qualifying" employee is an employee who has been employed by the employer for one year or more, and who for the preceding year, had compensation not in excess of 60% of the compensation threshold for highly-compensated employees ($120,000 for 2018). The credit would be equal to 12.5% of the amount of wages paid, increased by 0.25% for each percentage point by which the rate of payment exceeds 50% (but not to exceed 25% of the wages paid). The maximum amount of family and medical leave that may be taken into account with respect to any employee for any taxable year is 12 weeks. *Effective Date: For wages paid in 2018 and 2019 (provision sunsets after 2019)* (Section 13403)

Provision (Code Section)	Current Law	New Law (Bill Section)
HEALTH & WELFARE BENEFITS		
CPI-U for Tax Code Indexing for Health FSAs, HSAs, transit and parking limits, "Cadillac Tax" (Code Section 1(f))	Various Tax Code dollar thresholds/maximum contribution limits are adjusted for inflation based upon annual changes in the standard DOL-published Consumer Price Index for all Urban Consumers (CPI-U).	Replaces the use of the CPI-U as the inflation adjustment with what is commonly referred to as the "Chained CPI-U." Use of the Chained-CPIU is expected to result in relatively reduced inflation adjustments when compared to the standard CPIU-U. It is expected that statutory maximum contribution limits applicable to HSAs and health FSAs, among others, would increase at a slower rate than if CPI-U continued to apply. Similarly, for purposes of indexing the dollar thresholds for coverage that triggers the Cadillac Tax under Code Section 4980I would also increase at a slower rate. *Effective Date: Taxable Years Beginning After December 31, 2017 (no sunset)* (Section 11002)

Provision (Code Section)	Current Law	New Law (Bill Section)
FRINGE BENEFITS		
Deduction for Entertainment, Amusement, Recreation Expenses (Code Section 274)	Employers may deduct only 50% of otherwise deductible expenses for entertainment, amusement, recreational activities, and membership dues if the expenses directly relate to their business.	Employer deduction eliminated (unless an exception applies). *Effective Date: Amounts paid or incurred after 2017* (Section 13304)
Deduction for Meals, Food and Beverages (Code Section 274)	Employers may deduct for ordinary and necessary business expenses for meals, food, and beverages. Any deduction for meals, whether entertainment or not, is subject to a 50% limit, unless an exception applies. Food and beverages that can be excluded from an employee's income as a de minimis fringe benefit, including expenses for an employee cafeteria located on or near the employer's business premises, can be fully deducted.	Employer deduction eliminated for meals, food, or beverages, to the extent that such expenses are entertainment, amusement, or recreation (unless an exception applies). For amounts incurred and paid after December 31, 2017 and until December 31, 2025, employer expenses associated with providing food and beverages to employees through an on-premises eating facility that meets requirements are subject to 50% limitation. Beginning in 2026, any deduction for employee cafeterias would be completely eliminated, as would any deduction for meals furnished for the convenience of the employer on the business premises of the employer. *Effective Date: Generally, amounts incurred and paid after December 31, 2017* (Section 13304)

Provision (Code Section)	Current Law	New Law (Bill Section)
FRINGE BENEFITS		
Deduction for Qualified Transportation Fringe Benefits (Code Section 274)	A taxpayer may deduct the cost of certain fringe benefits provided to employees, including transportation fringe benefits, even though such benefits are excluded from the employee's income. Qualified transportation fringes include parking, transit passes, and vanpools.	Employers can no longer take a deduction for providing qualified transportation fringes or for expenses incurred for providing transportation for commuting between an employee's residence and place of employment, except for ensuring the safety of an employee. The tax exclusion for qualified transportation fringe benefits is generally preserved for employees. *Effective Date: Amounts paid or incurred after 2017* (Section 13304)
Qualified Bicycle Commuting Reimbursement (Code Section 132(f))	Employees may exclude from their income qualified bicycle commuting reimbursements of up to $20 per month. These amounts are also excluded from wages for employment tax purposes.	Repeal the exclusion for qualified bicycle commuting reimbursements. *Effective Date: For taxable years beginning after 2017 and before 2026 (provision sunsets after 2025)* (Section 11047)

Provision (Code Section)	Current Law	New Law (Bill Section)
FRINGE BENEFITS		
Deduction for Qualified Moving Expense Reimbursements	Employees may exclude employer-provided moving expense reimbursements from gross income and wages for employment tax purposes.	Employees will not be able to exclude qualified moving expense reimbursements from income or deduct moving expenses, but provides an exception for certain members of the Armed Forces on active duty who move pursuant to a military order. *Effective Date: Amounts paid or incurred after 2017 and before 2026 (provision sunsets after 2025)* (Section 11048)
Employee Achievement Awards (Code Sections 74(c) and 274(j))	Employee achievement awards for length of service or safety achievements up to a certain amount are excluded from employees' income if certain conditions are met and are also excludible from an employee's gross income and wages for employment tax purposes.	The deductibility of employee achievement awards is limited by a new definition of "tangible personal property" that denies the deduction for cash, cash equivalents, and gift cards, coupons, or certificates, vacations, meals, lodging, tickets to sporting or theater events, securities, and "other similar items," except when employees can only choose from a limited array of pre-selected or pre-approved items by the employer. *Effective Date: Taxable years beginning after December 31, 2017* (Section 13310)

Provision (Code Section)	Current Law	New Law (Bill Section)
RETIREMENT BENEFITS		
Extended Rollover Period for Plan Loan Offset Amounts (Code Section 402(c))	Retirement plan loans are generally immediately due and payable when the plan terminates or the participant terminates employment. If the loan is not repaid (i.e., defaults), the participant is deemed to have received a taxable distribution to "offset" the outstanding unpaid loan balance. Because this "offset" amount is treated like an ordinary distribution, the participant could make a tax-free rollover contribution to another retirement plan or an IRA so long as the individual does so within 60 days of the distribution.	Extends the 60-day deadline until the due date (including extensions) for the participant's tax return for the year in which the amount is treated as distributed. Plan loan offset amounts qualifying for this extended deadline are limited to loan amounts that are treated as distributed solely by reason of either termination of the plan or failure to meet the loan's repayment terms because of a severance from employment. The extension applies to plan loans provided by tax-qualified retirement plans including, Section 401(k), Section 403(b) and Section 457(b) governmental plans. *Effective Date: Applies to loan offset amounts that are treated as distributions in taxable years beginning after December 31, 2017* (Section 13613)
Special Relief for 2016 Disaster Victims	Distributions from 401(k), 403(b), 457(b) plans, and IRAs are generally included in income for the year distributed. Additionally, such distributions received before age 59-½ are subject to a 10% early withdrawal tax. If eligible, a distribution from a 401(k), 403(b) plan, 457(b) plan, or IRA may be rolled over tax-free to another eligible retirement plan within 60 days.	The Bill provides tax relief for certain retirement plan and IRA distributions taken on or after January 1, 2016, and before January 1, 2018, by individuals: (1) whose principal place of abode was located in a presidentially declared disaster area at any time during 2016, and (2) who sustained an economic loss by reason of the events giving rise to the disaster declaration. The relief is similar to the retirement related tax relief enacted after Hurricanes Katrina, Wilma, and Rita in 2005, and Hurricanes Harvey, Irma, and Maria in 2017.

Provision (Code Section)	Current Law	New Law (Bill Section)
RETIREMENT BENEFITS		
Special Relief for 2016 Disaster Victims (continued)		The aggregate distributions from all eligible retirement plans eligible for tax relief is $100,000. The tax relief includes: • relief from the 10% early withdrawal tax and from the 20% mandatory income tax withholding; • the distribution will be exempt from certain statutory limitations, such as 401(k) plan restrictions on taking distributions of pre-tax deferrals before age 59-1/2; • taxable income from the distribution may be spread out ratably over three years; and • any portion of the distribution may be recontributed as a “rollover” to any eligible retirement plan to which a rollover can be made within a three-year period from the year of the distributions. Any retroactive plan amendments made to adopt the tax relief provided by the Bill (or by a regulation issued thereunder) may be made by the last day of the first plan year beginning after Dec. 31, 2017 (i.e., December 31, 2018 for calendar year plans). *Effective Date: Immediate* (Section 11028)