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Employee Benefits and Compensation

EMPLOYEE HANDBOOK

December 2017

Tax Cut Impacts on Executive Compensation and Employee Benefits

After much back and forth, the House and Senate both voted to pass the Tax Cuts and Jobs Act (Act), and the President is expected to sign the legislation shortly. The changes made by the Act are arguably the biggest leap towards comprehensive tax reform of the Code since 1986. Below are highlights of certain provisions as they relate to executive compensation and employee benefit plans. While not all plans and plan sponsors will be impacted by these changes, we encourage you to review these with your tax advisor and counsel to determine whether you need to take action.

EXECUTIVE COMPENSATION

- Executive Compensation of Public Companies' Executives. Generally, an employer may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) of the Code provides a limitation on the deductibility of compensation expenses for publicly traded employers, and the otherwise allowable deduction for compensation expenses with respect to covered employees, that is, the CEO and CFO as of the close of the taxable year and the other four highest-paid officers for the taxable year (other than the CEO and CFO), is limited to no more than $1 million per year.

  The Act eliminates the performance-based exemption, which is likely to cause most compensation payable to executive officers of a public reporting company to be nondeductible. Additionally, Section 162(m) is expanded to include all SEC reporting companies, including those with publicly traded debt.

  Transition relief will be available in any case where there is a written, binding contract in effect as of November 2, 2017, and such agreement is not materially modified after that date.

- Excise Tax on Excessive Compensation for Executives of Tax-Exempt Organizations. Generally, a 21 percent excise tax on tax-exempt organizations will be applied in the event the tax-exempt organization pays compensation in excess of $1 million to any person who is, or was in a prior taxable year beginning after December 31, 2016, one of the five highest-paid employees of the organization. For more information on the tax implications affecting executive compensation and employee benefit plans of tax-exempt organizations, click here.

- Deferred Taxation on Option/Restricted Stock Unit (RSU) Shares Issued to Employees of Start-Up Corporations. Effective for options exercised or RSUs settled after December 31, 2017, a new subsection 83(i) has been added to Section 3401 of the Code, which allows nonexecutive employees and non–highly-compensated employees of privately held companies to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer for up to five years. An individual serving as CEO or CFO, or certain persons related to them, or any person who in the past ten years was one of the four highest-paid officers of the company or a one percent shareholder, notwithstanding that such individual may not have

been among such categories for the ten preceding taxable years (excluded employee), may not make a deferral election.

An election to defer income inclusion with respect to qualified stock must be made no later than 30 days from the first time the employee's right to stock is substantially vested or transferable, whichever occurs first, and is made in a similar manner in which a Section 83(b) election is made. Options or RSUs must be granted under an equity compensation plan that provides at least 80 percent of all full-time, U.S. employees with grant awards with the same rights and privileges. Amounts of the awards may vary by employee, provided each employee receives more than a de minimis grant. This requirement cannot be satisfied by granting a combination of stock options and RSUs.

If an employee elects to defer income inclusion, the income must be included in his or her income for the taxable year that includes the earliest of (1) the first date the qualified stock becomes transferable, including to the employer, (2) the date the employee becomes an "excluded employee", (3) the first day on which any stock of the employer becomes readily tradeable on an established securities market, (4) the date five years after the first date the employee's right to stock becomes substantially vested, or (5) the date on which the employee revokes his or her election. Finally, the exception from treatment as a nonqualified deferred compensation plan for Section 409A purposes applies only with respect to an employee who may receive qualified stock.

Until such time that the Secretary of the Treasury issues regulations or additional guidance, employers who make a reasonable good faith interpretation and effort under the requirements will be treated as complying with the 80 percent requirement.

- Excise Tax on Certain Transactions Resulting in Expatriated Corporation. The excise tax is increased to 20 percent on the value of stock compensation held by insiders of an expatriated corporation. This applies to corporations first becoming expatriated corporations after the date of the enactment of this Act.

RETIREMENT PLANS

- Rollover Rules Regarding Loan Amounts. If a loan amount is distributed due to plan termination or a plan participant's failure to repay the loan due to a severance from employment, the loan amount may be rolled over prior to the due date for filing the plan participant's federal income tax return for the year of the plan termination or plan participant's severance from employment.

- Length of Service for Bona Fide Public Safety Volunteers. The aggregate amount of length of service awards that may accrue for a bona fide volunteer with respect to any year of service is increased to $6,000 (up from $3,000) and adjusts in $500 increments to reflect a cost-of-living adjustment after the first year the provision is in effect. For defined benefit plans, the limit applies to the actuarial present value of the aggregate amount of length of service awards accruing with respect to any year of service.

WELFARE, FRINGE BENEFIT, AND PAID LEAVE

- Affordable Care Act Individual Mandate. The individual mandate, as required under the Affordable Care Act, is repealed, effective in the months after December 31, 2018.

- Moving Expense Reimbursement. The employee income tax exclusion for reimbursements provided by employers is eliminated for taxable years beginning after December 31, 2017, and before January 1, 2026.

- Employee Achievement Awards. The employee income tax exclusion for certain achievement awards is eliminated for amounts paid or incurred after December 31, 2017. Cash, gift cards/certificates, vacations, meals, lodging, theater, and sporting event tickets and securities will no longer qualify as employee achievement awards.

- Qualified Transportation Benefits and Qualified Bicycle Commuting. Employers may continue to offer qualified transportation benefits (other than bicycle commuter reimbursements) to employees on a tax-free basis; however, employers will no longer be permitted to deduct qualified transportation benefits. Additionally, the exclusion for qualified bicycle commuting expenses is suspended for taxable years beginning after December 31, 2017, and before January 1, 2026.

- Entertainment and Meals Expense. The employer deduction for entertainment expenses is eliminated, and the deduction for meal expenses is limited to 50 percent. In addition, deductions for meals provided for the convenience of the employer on or near its premises is eliminated for taxable years after 2025.

- Unrelated Business Taxable Income. Unrelated Business Income Tax (UBIT) now includes any expenses paid or incurred by the organization for qualified transportation fringe benefits and parking facilities used in connection with qualified parking benefits, provided the amounts are not otherwise deductible under Section 274 of the Code.

- Employer Credit for Paid Family and Medical Leave. A general business tax credit available for employers is equal to 12.5 percent, with the credit increasing by 0.25 percentage points, but never above 25 percent for each percentage point by which the rate of payment exceeds 50 percent of wages paid to qualifying employees during certain family and medical leave. To be eligible for the credit, employers must provide at least two weeks of paid leave annually to employees whereby they receive at least 50 percent of their normal wages. This general tax credit will be available for the 2018 and 2019 tax years.

For more information or if you have questions about how the issues raised in this legal update affect your policies, practices, or other compliance efforts, please contact one of the lawyers listed below:

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