Lathrop GPM

eBenefits Alert: Tax Legislation—How Will Compensation and Benefit Plans Be Affected?

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Just in time for the Winter Solstice, a tax bill has passed the House, the Senate, and the House again, and is expected to be signed by President Trump soon. What will it mean for your business's compensation and benefits strategy?

Compensation for Highly Compensated Employees of Nonprofits will be subject to excise taxes if it is in excess of $1 million in a tax year, or if it constitutes an "excess parachute payment." The excise tax is equivalent to the new corporate tax rate of 21%, and applies to the nonprofit—not to the employee. Essentially, this change applies the principles of Sections 162(m) and Section 280G of the Internal Revenue Code—both of which previously applied only to publicly-traded corporations—to nonprofit organizations.

Highlights of the excise tax on compensation in excess of $1 million:

- It applies to the five most highly compensated employees—with an exception for licensed medical professionals to the extent their compensation is for medical services
- It applies to any employee who is in the top five for the current or any prior year beginning after 2016—in other words, the number of employees to whom it applies can rise over the years
- Compensation is treated as paid when it is no longer subject to a substantial risk of forfeiture (i.e. when it vests)—this means that vesting in deferred compensation plans could affect whether the cap is exceeded
- Effective for tax years beginning after Dec. 31, 2017

Highlights of the excise tax on "excess parachute payments":

- A parachute payment is any payment contingent on separation from service—except payments from qualified retirement plans—but including payment from nonqualified deferred compensation plans

- This excise tax is not limited to the top five employees—it applies to any highly compensated employee (i.e. more than $120,000 in 2018). There is an exception for payments to licensed medical professionals for medical services.

- The excise tax applies if the parachute payment is more than three times the employee's average annual compensation for the five tax years before the separation.

- The excise tax applies to the amount that is greater than the average annual compensation for the previous five years—in other words, the threshold for application of the tax is three times the average compensation, but if it applies, the tax applies to any amount in excess of one time the average compensation.

Compensation for Top-Paid Employees of Publicly Traded Corporations has long been non-deductible if it exceeds $1 million, but commissions and "performance-based" compensation did not count toward the cap. Now those types of compensation, such as stock options and stock appreciation rights, will count toward the cap. Highlights of the other changes:

- The cap applies to compensation for the CFO, CEO, and three other highest paid employees

- Once an employee is covered by the cap, the employee remains covered by the cap—thus, the number of employees to whom it applies can rise over the years.

- Grandfathering for binding agreements in effect on Nov. 2, 2017.

- Also applies to companies that register debt securities with the SEC

- Effective for tax years beginning after Dec. 31, 2017

Taxation on **Qualified Equity Grants** may be deferred. Upon the receipt of stock through the exercise of a nonqualified stock option or the settlement of restricted stock units (RSUs) after Dec. 31, 2017, eligible employees may elect to defer taxation for up to five years if certain requirements are met. The grant must be made by a private company employer in connection with the performance of services as an employee, and the employer must have a written plan under which, in such calendar year, at least 80% of its employees are granted stock options or RSUs. Employees excluded from making a deferral election include any employee who is (i) a 1% owner of the employer, (ii) a current or former CEO or CFO of the employer (or certain relatives of a current or former CEO or CFO), or (iii) one of the four highest compensated officers for that taxable year or any of the preceding 10 taxable years.

Certain Fringe Benefits will no longer be excluded from taxation. Employees won't be able to get tax-free treatment of their employer-paid moving expenses, or their bicycle commuting benefits.

- Bicycle benefit exclusion is suspended after Dec. 31, 2017 and reinstated on Jan. 1, 2026.

Employees can still get other **transportation fringe benefits** (parking, commuter passes) on a tax-free basis, but the employer won't get a deduction for those plans. Reimbursement for entertainment, amusement, recreation, and club membership dues will also no longer be deductible by the employer, even if related to the employer's trade or business.

Congress considered eliminating the exclusion for Dependent Care Assistance benefits, Adoption Assistance benefits, Educational Assistance benefits, and Tuition Reduction benefits, but these types of benefits survived—one area where no changes are needed.

Retirement Benefit Changes include:

- Roth IRA conversions cannot be recharacterized
- Governmental retirement plans can allow in-service distributions to start as early as age 59
- Longer period of time available to rollover a plan loan offset, so as to avoid the loan amount being treated as a taxable distribution

Repeal of the Individual Mandate under the Affordable Care Act. What would an eBenefits alert be without a mention of the ACA? Technically, the individual mandate remains in the law, but the penalty associated with an individual's failure to have health coverage is reduced to $0. **This is not effective until the beginning of 2019**. The bill does NOT repeal the employer mandate.

Gray Plant Mooty will be following these changes and more as they are implemented. Stay tuned to eBenefits, and call your Gray Plant Mooty lawyer if you have questions.