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BENEFITS & COMPENSATION UPDATE

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President Signs H.R. 1 (Tax Cuts and Jobs Act)

On December 22, 2017, President Trump signed into law H.R. 1, commonly referred to as the "Tax Cuts and Jobs Act" (the "Act"). The following is a summary of important provisions in the Act relating to employee benefits and executive compensation matters.

Retirement Plans

Repeal of Recharacterizations of Roth IRA Conversions. The Internal Revenue Code (the "Code") currently allows an individual who makes a contribution to an IRA (traditional or Roth) to recharacterize the contribution as a contribution to the other type of IRA so long as it is done before the due date of the individual's tax return (including extensions). Similarly, an individual who converts a traditional IRA to a Roth IRA may unwind the conversion in the same time frame. Beginning in 2018, the Act eliminates the ability to unwind a conversion from a traditional IRA to a Roth IRA. The Act does not eliminate the ability to recharacterize a contribution made to a Roth IRA as a contribution to a traditional IRA (or vice versa).

Extension of Rollover Period for Plan Loans. An employer-sponsored tax-qualified retirement plan may allow participants to take loans from their plan account. Under current law, when a plan participant terminates employment with an outstanding plan loan and does not repay the loan, the participant has 60 days to make a tax-free rollover of the unpaid loan balance to an IRA in order to avoid having it become a taxable distribution. The Act extends this rollover period from 60 days to the due date (including extensions) for filing the tax return for the taxable year in which the unpaid loan balance would otherwise be taxable. The same rule applies to participants whose plan terminates while they have an unpaid loan balance. This change is effective for tax years beginning after 2017.

Executive Compensation

Limits on Deduction for Executive Pay. Code Section 162(m) limits deductions by corporations with publicly traded stock for compensation paid to a covered employee in excess of $1 million/year. The new law significantly expands this limitation by expanding the types of compensation that count toward the $1 million cap, the group of executives who are covered employees for purposes of Code Section 162(m), and the employers who are subject to the deduction limit.

First, the Act eliminates the exceptions for commission-based or performance-based compensation. Equity compensation and executive bonus plans, compensation under which was in the past generally excluded for purposes of applying the $1 million cap, now count against the cap.

Second, employees covered under the new law are the principal executive officer and principal financial officer at any time during the tax year plus the three other highest paid employees. More significantly, whereas the status of an executive as a covered employee was previously determined on a year-by-year basis, individuals who are covered employees in 2017 or future years permanently retain their status as such. As a result, the cap will now apply to amounts paid to former executives (or their beneficiaries), such as severance pay or deferred compensation.

Lastly, employers who are subject to the deduction limitation imposed by Code Section 162(m) will now include all domestic corporations with any publicly-traded stock or debt, and foreign companies publicly traded in the U.S. through American Depositary Receipts ("ADRs").

The new law is generally effective for tax years beginning after 2017; however, compensation paid under contracts in effect as of November 2, 2017, are grandfathered under the old rules, so long as they are not modified in any material respect on or after that date.

New Qualified Equity Grants. The Act adds Code Section 83(i), which creates a new type of equity grant of stock options or restricted stock units ("RSUs") that corporations without publicly traded stock can provide to rank-and-file employees. If structured properly, eligible employees will be able to defer taxation on these awards for up to five years after the exercise of the options or vesting of RSUs.

An employee is not eligible for the election if he or she:

- is or was a 1% owner of the corporation at any time during the current, or 10 preceding, years;
- is, or at any time was, the CEO or the CFO of the corporation (or a family member of such an individual); or
- is or was one of the four highest paid officers of the corporation in the current year or any of the 10 preceding years.

Qualified stock includes any stock in the corporation that is the employer of the employee that is received in connection with the exercise of an option, or in settlement of an RSU, which is granted in connection with the performance of services. Qualified stock may also include stock underlying statutory stock options, including incentive stock options (or "ISOs") or options issued under an employee stock purchase plan ("ESPP"); however, if an employee makes a deferral election with respect to such stock, it will no longer be considered a statutory stock option. If an employee can receive cash in lieu of the stock at the time the rights of the employee in the stock become transferrable or not subject to a substantial risk of forfeiture, then it is not qualified stock.

The corporation must have a written plan that provides that at least 80% of employees of the corporation providing services in the U.S. are to be granted stock options or RSUs with the same rights and privileges. The number of shares granted to all employees under the plan need not be equal but each employee must receive more than a *de minimis* amount. Corporations issuing such equity grants are required to provide employees with notice of their eligibility to make the deferral election.

Under a transition rule, until the IRS issues regulations or other guidance, corporations will be treated as complying with the 80% rule and the notice requirement if they comply with a reasonable good faith interpretation. The new rules would generally apply to stock attributable to options exercised, or RSUs settled, in 2018 or later.

Health and Welfare

Affordable Care Act Individual Mandate. The new law effectively eliminates the individual mandate to obtain qualifying health coverage, a key component of the Affordable Care Act, by eliminating the penalty for non-compliance beginning in January 2019. (The individual mandate and associated penalty will remain in effect throughout 2018.)

New FMLA Employer Credit. Currently, employers do not receive a tax credit for providing paid family and medical leave to their employees. Now, under the Act, for tax years 2018 and 2019 only, employers may claim a business credit of 12.5% of wages paid to qualifying employees on family or medical leave who are receiving at least 50% of their normal wages. The credit increases by 0.25% for each percentage point by which the payment rate exceeds 50% of the employees' normal rate, making the maximum available tax credit 25%. The maximum amount of leave that may be claimed for this credit with respect to a qualifying employee is 12 weeks per year.

Qualifying employees are those individuals who are employed for at least one year and in the preceding year did not have compensation greater than 60% of the threshold for determining "highly-compensated employees" (i.e., for 2018, employees who made not more than $72,000 (i.e., 60% × $120,000) in 2017).

The employer must maintain a written policy that allows all full-time qualifying employees at least two weeks of annual paid family and medical leave (and a commensurate pro rata amount of leave for part-time employees).

Employer-Provided Fringe Benefits

Changes Affecting Employer Deductions. The Act eliminates or reduces the deduction that employers can take for certain expenses and benefits, including:

- eliminating the deduction for entertainment or recreation expenses, or for the operation of a social club, related to the active conduct of a trade or business;
- eliminating the deduction for providing qualified transportation fringe benefits or for expenses relating to employee commuting (except as necessary for the employee's safety); and
- imposing a 50% limit on the deduction for providing *de minimis* food and beverage fringe benefits to employees beginning in 2018 and eliminating the deduction altogether, along with the deduction for providing meals to employees for the convenience of the employer, beginning in 2026.

Changes Affecting Employee Deductions and Exclusions. The Act also makes changes to the exclusions and deductions available to employees for certain job-related expenses, including the following:

- suspending the exclusion from gross income and wages for employer-provided bicycle commuting reimbursements for taxable years 2018 through 2025; and
- suspending the exclusion from gross income and wages for employer-provided qualified moving expense reimbursements, and the deduction by an individual for moving costs associated with relocating for a new job, for taxable years 2018 through 2025.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

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