



Employee Benefit Issues After Tax Reform

Anne G. Batter, Partner – *Baker & McKenzie LLP*

Jennifer George, Partner - *PwC*

Rick Berge, Executive Director - *EY*



TAX EXECUTIVES INSTITUTE, INC.

TEI-SJSU High Tech Tax Institute
November 5, 2018

Agenda

- Significant changes to section 162(m)
- Qualified equity grants
- Fringe Benefits
- Other Miscellaneous Provisions



TAX EXECUTIVES INSTITUTE, INC.

Tax Reform Effectiveness, Current Status and Pending Guidance

- Tax Cuts and Jobs Act (**TCJA**) – signed into law December 22, 2017
- Generally effective as of January 1, 2018 or for tax years beginning after December 31, 2017
- Guidance / Interpretation of new law?
 - Joint Explanatory Statement of the Conference Committee
 - “Blue Book” by Joint Committee on Taxation
 - Treasury and IRS guidance and regulations
 - Technical corrections bill may be necessary (though hard to pass)



TAX EXECUTIVES INSTITUTE, INC.

3

Section 162(m) - \$1M limit

Prior law

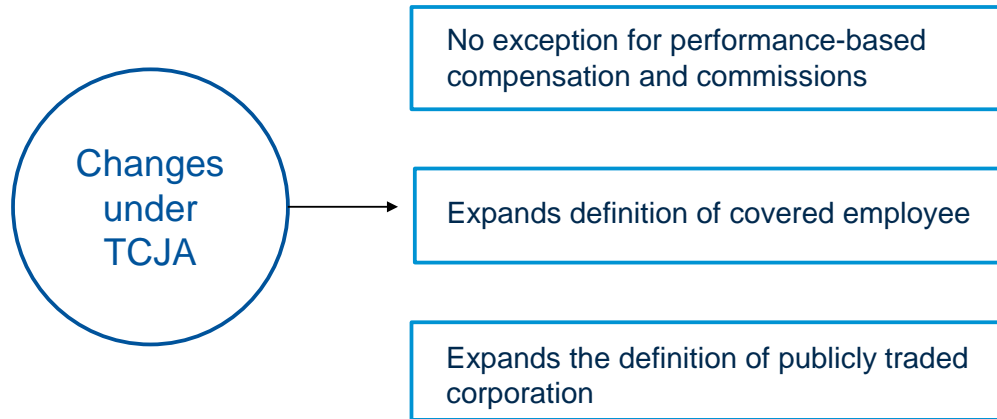
- Limits a public corporation's deduction to \$1M per covered employee per year
- Qualified performance-based compensation and commissions exempt from the limit
- Four (max) covered employees per year:
 - CEO as of the last day of the taxable year
 - Three highest paid officers other than the CEO and CFO serving on the last day of the taxable year
 - Based on SEC proxy disclosure rules
- CFO's compensation was not subject to the \$1M limit



TAX EXECUTIVES INSTITUTE, INC.

4

Section 162(m) - \$1M limit



Generally effective for taxable years beginning after December 31, 2017



TAX EXECUTIVES INSTITUTE, INC.

5

Section 162(m)

Covered employee – new definition

- CEO and CFO at any time during the taxable year (not just the last day)
- Three highest paid officers serving on the last day of the year other than the CEO and CFO (determined under SEC proxy disclosure rules)
- If an individual is a covered employee in any tax year beginning after December 31, 2016, he or she is a covered employee in all future years
- Impact:
 - Possibly more than five covered employees in a given year
 - Amounts paid to a covered employee in or after year of termination is subject to the limit (including payments after termination or death)



TAX EXECUTIVES INSTITUTE, INC.

6

Section 162(m)

Transition rule relief:

- Remuneration pursuant to a written binding contract in effect on November 2, 2017 which is not modified in any material respect
 - Any renewal treated as a new contract
 - Extent of relief is unclear:
 - What if amount payable is subject to discretion, including negative discretion?
 - What if contract can be amended or terminated, other than prospectively?
 - What if annual cash bonus has no separate written contract?
 - What if equity award is not accepted/not required to be accepted?



TAX EXECUTIVES INSTITUTE, INC.

Section 162(m)

- Query whether to amend plan provisions to increase flexibility regarding performance-based comp (but beware of state tax and securities disclosure implications and shareholder views):
 - No need for shareholder approval just to satisfy Section 162(m) requirements
 - Eliminate individual limits on maximum payments
 - Provide for subjective performance goals
 - Ok to design performance goals based on “substantially similar” business criteria that are not specifically described in the plan
 - Performance goals may be set after the first 90 days of the performance period (or after the first 25% of the performance period)



TAX EXECUTIVES INSTITUTE, INC.

Section 162(m)

- No need to have Comp. Comm. certify achievement or to have Comp. Comm. made up of independent directors just to satisfy Section 162(m) requirements
- Ok to adjust payouts upwards as well as downwards
- Ok to pay at target upon termination of employment – no need to wait for actual performance results
- But, consider:
 - Demands of proxy advisory firms and other stakeholders
 - Retaining transition rule relief for existing awards, if available – consider stating that plan changes only apply prospectively to new awards
 - Proxy disclosure that amounts are not deductible and of changes in plan design



Section 162(m) – Notice 2018-68

- Definition of covered employee
 - Any employee in PEO or PFO role at any time during tax year
 - Any other employee whose compensation is required to be disclosed to shareholders under SEC rules by virtue of being one of three highest paid officers
 - Clarifies that end of tax year rule inapplicable – covered employee does not have to be employed at end of tax year to be subject to deduction limitation
 - Covered employee can be subject to deduction limitation even if covered employee not required to be disclosed in proxy



Section 162(m) – Notice 2018-68

- Remuneration provided pursuant to written binding contract
 - Written binding contract must have been in effect as of November 2, 2017
 - Must not have been “materially modified” after November 2, 2017
 - Material modification is generally increase in amount payable under agreement
 - Corporation must be obligated under applicable law (e.g., state contract law) to pay amount under agreement if performance conditions satisfied
 - Example in Notice indicates that “negative discretion” to reduce or eliminate payment could preclude finding of binding contract
 - Amounts payable under written binding contract to pre-TCJA non-covered employee (e.g., PFO) not subject to Section 162(m) deduction limitation



Agenda

- Significant changes to section 162(m)
- Qualified equity grants
- Fringe benefits
- Other miscellaneous provisions



Creation of Section 83(i): Potential Deferral of Taxation of Equity Awards for Private Companies

- Election can be made by employees (not mandatory); similar to an 83(b) election for restricted stock
- Non employees such as independent contractors and non employee directors may not make this election
- If election is timely made, income tax (not other types of tax) can be deferred until generally the earlier of when shares become tradeable or five (5) years after the “normal” taxable event (i.e., exercise for stock options)
- Can apply to restricted stock units, stock options and employee stock purchase plans
- Although ISOs do qualify, ISO status will be lost if 83(i) election is made
- Deferral elections will be similar to 83(b) elections and must be made within thirty (30) days after shares are issued



Creation of Section 83(i): Potential Deferral of Taxation of Equity Awards for Private Companies

- Key conditions to apply deferral are as follows:
 - Must grant equity awards to 80% of employees on same terms- although amounts can vary provided not de minimus (excluding part time employees and employees that are not eligible for deferral)
 - Shares are not publicly traded at time of issuance (and deferral ends upon IPO)
 - Employees cannot have a right to sell shares to company at time shares are issued
 - Companies that have bought back shares in prior year may not qualify for deferral (rules complex)
 - Company must provide a notice to employees that this deferral is available



Creation of Section 83(i): Potential Deferral of Taxation of Equity Awards for Private Companies

83(i) Deferral is not available to the following individuals:

- Any person who is or has been (or has acted as) the CEO or CFO
- Any person who in the preceding 10 years was a 1% shareholder
- Family members of the above
- Any of the four highest-paid officers of the issuing company for the current or previous 10 years



TAX EXECUTIVES INSTITUTE, INC.

15

Agenda

- Significant changes to section 162(m)
- Qualified equity grants
- Fringe Benefits
- Other Miscellaneous Provisions



TAX EXECUTIVES INSTITUTE, INC.

16

Fringe Benefits - Miscellaneous

The TCJA impacted the following fringe benefits and other miscellaneous topics:

- Transit and Commuting Benefits
- Moving Expenses
- Meals and Entertainment Provided to Employees
- Employee Achievement Awards



TAX EXECUTIVES INSTITUTE, INC.

17

Transit and Commuting

The legislation's focus in this area is on deduction disallowances, rather than on making the benefit taxable to the employees

Two separate changes made:

1. Section 274(a)(4) impacts deduction for expenses of "qualified transportation fringes"
2. Section 274(l) separately impacts the deduction for commuter benefits



TAX EXECUTIVES INSTITUTE, INC.

18

Transit and Commuting

Section 274(a)(4) disallows the employer's deduction for the costs of "qualified transportation fringes:"

- Commuter shuttles/vans
- Transit passes
- Qualified parking
- Qualified bicycle reimbursement



TAX EXECUTIVES INSTITUTE, INC.

19

Transit and Commuting

Section 274(l) disallows the employer's deduction for the costs of providing transportation between an employee's place of residence and work, except as necessary for ensuring the safety of the employee

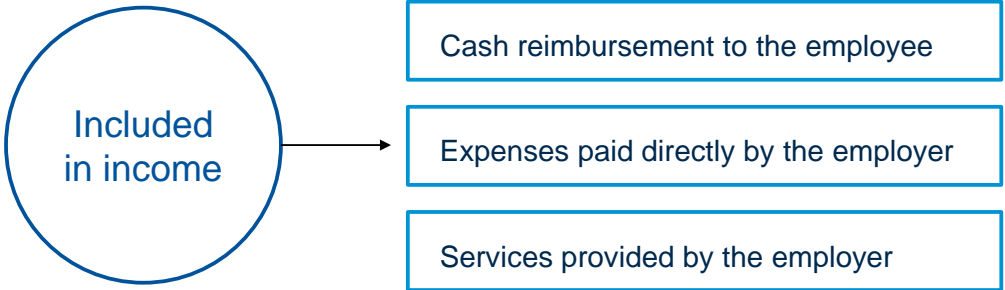
- Significant overlap with commuter shuttles/vans and transit benefits disallowed in Section 274(a)(4)
- This can be a double hammer where commuting benefit is taxable
- The reach of the exception for the safety of the employee is not clear



TAX EXECUTIVES INSTITUTE, INC.

20

Qualified moving expense reimbursement now taxable

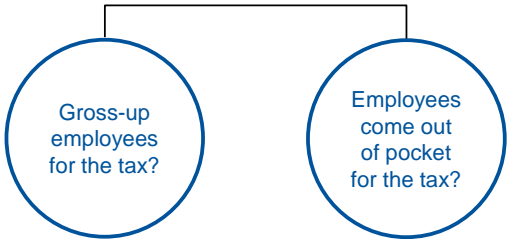


Qualified moving expense reimbursement

TCJA suspends section 132(a)(6)

- Repeals exclusion from income for qualified moving expense reimbursement
- Applies to 2018 – 2025 taxable years (Notice 2018-75 clarifies that no impact for expenses incurred in 2017 but reimbursed in 2018)
- May be more costly to hire or transfer employees

How will employers react?



Meals Provided to Employees

- Changes to Section 274 Impact Entertainment and Meals, with Employee Meals Being a Large Focus
- As background, the TCJA did away with the exception from deduction disallowance under section 274(a) for entertainment directly related to or occurring immediately before or after business
- This led to questions whether business meals with clients would be 100 percent disallowed as entertainment
- Notice 2018-76 clarifies the IRS position that business meals remain 50 percent deductible.
 - For this purpose, business meals include meals taken at a sports venue, as long as the meal portion of the expense is separately stated



Meals Provided to Employees

The TCJA also did away with a number of exemptions from deduction disallowance for employee meals.

De minimis meals that are no longer exempt from 50 percent deduction disallowance due to repeal of Section 274(n)(3):

- Coffee and doughnuts
- "Group meals"
- Subsidized company cafeterias
- Section 119 meals

This provision is effective for amounts paid or incurred after December 31, 2017



Meals Provided to Employees

New section 274(o) disallows:

- the expenses for operation of a facility described in section 132(e)(2) (a subsidized employer cafeteria), including the food or beverage expenses
- any expense for section 119(a) meals

This provision is effective for amounts paid or incurred after December 31, 2025



TAX EXECUTIVES INSTITUTE, INC.

25

Employee achievement awards

No substantial changes to law – just a clarification

Excludible from income:

- Awards of tangible personal property in recognition of length of service or safety achievement as part of a meaningful presentation.
- Cannot be disguised compensation
- Excludible from income to the extent deductible by the employer
 - Generally up to \$1,600 per employee is deductible by the employer
- Must not discriminate in favor of highly compensated employees

The change under TCJA is not meant to be understood as a change from existing law



TAX EXECUTIVES INSTITUTE, INC.

26

Employee achievement awards

TCJA defines what is not tangible personal property

Effective for amounts paid or incurred after December 31, 2017

- Employee is not allowed to exclude the value from income unless the award is tangible personal property

Tangible personal property does not include:

Cash	Gift certificates (other than right to select and receive tangible personal property)	Tickets to theater and sporting events	Bonds
Cash equivalents			Other securities
Gift card and coupons		Lodging	Other similar items
Vacations		Meals	



TAX EXECUTIVES INSTITUTE, INC.

27

Agenda

- Significant changes to section 162(m)
- Qualified equity grants
- Fringe benefits
- Other miscellaneous provisions



TAX EXECUTIVES INSTITUTE, INC.

28

New Employer Credit

Employer-paid family and medical leave

Tax credit for wages paid in 2018 and 2019

- 12.5% of wages paid to qualifying employees during the period the employees are on family and medical leave (as defined under the Family and Medical Leave Act)
 - Rate of pay while on leave must be at least 50% of the employee's normal wages
- Credit increases by .25% for each percentage point by which the rate of pay exceeds 50% - maximum credit is 25% of wages
- Maximum period of leave eligible for the credit: 12 weeks



TAX EXECUTIVES INSTITUTE, INC.

29

Tax Credit Requirements

- Written policy
- All qualifying full-time employees (30 hours or more per week) at all related employers must be allowed not less than two weeks of annual paid family and medical leave
- Less than full-time employees must be allowed a prorated amount of paid leave
- Leave paid by a state or local government or required by state or local law does not count toward meeting the requirements



TAX EXECUTIVES INSTITUTE, INC.

30

Credit: Qualified Employee

- Any employee who has been employed for one year or more, and
- For the preceding year had compensation not in excess of 60% of the section 414(q) threshold for highly compensated employees
 - Section 414(q) in 2017: \$120,000, as indexed for inflation
 - Eligible employee in 2018: \$72,000 or less of compensation
 - \$120,000 X 60%

May provide paid leave to employees who do not qualify, but it does not count towards the credit



TAX EXECUTIVES INSTITUTE, INC.

31

Sexual Harassment Settlement Payments

Section 162(q) is added to the Code:

- Denies a deduction for settlement or other payments related to sexual harassment or sexual abuse if subject to a nondisclosure agreement
- Also denies a deduction for attorney's fees related to such settlement
- Effective for amounts paid or incurred after December 22, 2017



TAX EXECUTIVES INSTITUTE, INC.

32