WINSTEAD

Updates for the New Year - Executive Compensation & Benefits

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Sound Bites You May Have Heard on the ACA

In spite of certain sound bites you probably heard late last year, the Affordable Care Act ("ACA") was not repealed for employers. The individual mandate penalty was reduced to zero for a few years, beginning after 2018, so it still applies to individuals for 2017 and 2018. The employer still must do the annual reporting of coverage offered and benefits provided on Forms 1095-C and 1095-B, but the IRS delayed the due date for the employer to provide the applicable forms to the employees from January 31, 2018 for calendar year 2017 to March 2, 2018. There is no delay in the date by which employers must file the above forms with the Internal Revenue Service along with the applicable transmission form. Even though the deadline for providing employees their forms is delayed, some employees may want the forms to help them with filing their individual income tax returns at an earlier date when they are seeking tax refunds. (While it is not filed with the employee's return, some accountants want to see the form to know they are accurately preparing the individual's income tax return.)

There were no changes in the mandated benefit requirements for employer-sponsored group health plans. *The ACA requirements on employers and their group health plans remain the same, except for the slight delay in the deadline for providing forms to employees.* The employer shared responsibility tax remains alive and well and unchanged, so while employees will not be required to obtain coverage after 2018, employers will still need to offer coverage and may see a change in enrollment in their health plan when employees are no longer concerned about the individual mandate tax. Employers will want to be certain their plans have clearly communicated when enrollment will be available. To protect against adverse selection, once the employee mandate penalty is reduced to zero after 2018, annual enrollment materials (at the end of 2018 for 2019) should carefully to communicate the limits on changing elections after annual enrollment closes.

Disability Claim Procedure Effective Date is Finalized

The U.S. Department of Labor ("DOL") announced in a news release early this year that April 1, 2018 will be the applicability date for administering disability benefit claims in compliance with the disability claim regulations. The DOL reported, "Only a few comments responded substantively to the Department's request for quantitative data to support assertions that the final rule would drive up disability benefit plan costs by more than the Department had predicted, cause an increase in litigation, and consequently reduce workers' access to disability insurance protections. The information provided in the comments did not establish that the final rule imposes unnecessary regulatory burdens or significantly impairs workers' access to disability insurance benefits." *Thus, the final regulation issued late in the Obama administration will go into effect on April 1, 2018 with no changes, and employers should verify that all claims based on determining a disabled status will be handled in compliance with the new rules -beginning on April 1, 2018, regardless of the type of ERISA plan involved.*

PBGC Premium Payment Alternative Methods

While the PBGC has a website which employers can use to make PBGC premium payments at (MyPAA), *it is important for employers who find this a challenging method of paying premiums (due to PCAOB and auditor requirements for documentation) to remember that PBGC premiums can also be made using Pay.gov or simply an ACH or wire transfer from a financial institution.* The full PBGC premium payment instructions with explanations of alternate methods of payments and related requirements can be found at:
https://www.pbgc.gov/prem/premium-filing-payment-and-instructions

Proposed Regulation on Association Health Plans

Late last week, the DOL released proposed regulations affecting association health plans intended to make it easier for small employers to band together to purchase health coverage using the large group health plan rules. These are only proposed regulations, and many jurisdictions do not consider them something on which you can rely. These only alter the ERISA rules and do not change any rules related to issuance of group insurance under the various state insurance laws or any tax laws related to the trusts funding the benefits. The changes necessary to facilitate the growth of association health plans are still very early in the process, and it may be best to wait and watch as the various changes unfold until they eventually become final rules upon which employers can rely.

Tax Reform and Employee Benefits

On December 22, 2017, the latest tax reform bill was signed into law under the name of the Tax Cuts and Jobs Act. It will just be referred to here as tax reform. While an earlier alert noted a number of changes that early bills included, many of those provisions did not become law. There were still changes that impact employers and their benefit plans. The summary below will address only some of the changes enacted and will not discuss proposals that were not enacted. It will also not address income tax changes for entities, including partnerships or any partnership interest equity grants.

Retirement Plan Considerations

Disaster Relief

A provision permitting qualified disaster withdrawals for "2016 disasters" was enacted. This was similar to some disaster withdrawal legislation for prior disasters. The statute provides *two types of relief*, (1) to permit qualified retirement plans to allow certain qualified disaster hardship withdrawals *for qualified disasters which occurred in 2016* for provided these special distributions are paid in 2016 and 2017; and (2) to provide personal income tax relief for a personal casualty loss deduction which occurred in 2016 or 2017. *The Conference Report indicates that the casualty loss relief applies to losses arising in taxable years beginning after December 31, 2015 and before January 1, 2018, which would include the areas impacted by hurricanes in 2017 that were declared by POTUS as a major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, but it is key to distinguish which type of relief is being discussed because the qualified retirement plan distribution relief only applies to destruction of an individual's principal abode if it occurred in 2016 and met the requirements to be a Qualified 2016 Disaster Distribution (a "Q16DD").*

A Q16DD is not subject to the additional 10% income tax penalty for early withdrawals and can be repaid by the individual to the plan. A Q16DD must be for a qualified disaster which occurred in 2016. A Q16DD permits a distribution of up to $100,000 (subject to reduction) and permits the individual to include this in income over three years. Employers desiring to add these provisions to their retirement plans will need to amend their plans to add this provision by the end of the plan year beginning in 2018; however, employers should check with their plan's record keepers to ensure the record keeper will be in a position to administer the distribution and repayment provisions. The usefulness of this provision will depend on whether the record-keeping community decides to alter their systems to accommodate these provisions for the limited time period when they are available.

Compensation Definitions in Qualified and Nonqualified Plans

Moving expenses historically could have been reimbursed by an employer and were excluded from an employee's income (subject to limitations) and from some retirement plan compensation definitions. This income exclusion and related employer deduction have largely been repealed for moving expense reimbursements paid on or after January 1, 2018 and before 2026, with certain exceptions for persons moved due to military orders that meet certain requirements. (Employers and employees lose the deduction for moving expenses paid during such period, so these will be treated as additional compensation). This means that such reimbursements by non-military employers will need to be included in wages subject to income tax and FICA, etc. withholding taxes.

Because some retirement plans had historically excluded such reimbursements from compensation for plan purposes, employers will need to verify now that such amounts are included in compensation for retirement plan purposes. If an employer had added moving expenses into its plan compensation number in the past, it should ensure that such amounts are not added in twice just because the moving reimbursements will be included in income subject to income tax and FICA tax. Employers who regularly move employees to new work sites and who are hiring new employees may consider factoring in the taxation of the moving reimbursements into the relocation or new hire packages.

Nonqualified deferred compensation plans and nonqualified retirement plans should be reviewed to determine if the compensation definition utilized in such plan is impacted by the change made to the taxability of moving expenses to ensure that the appropriate compensation is used for benefit calculation and plan administration.

Plan Participants Who Owe Amounts to the Retirement Plan at Employment Termination

Participants who have outstanding loans from their retirement plan accounts when their employment terminates, or when their employer terminates the plan, will now have additional time in which to repay their loan (or pay the amount owed to an account receiving their rollover) to avoid being taxed on the value of the loan at their employment termination. The law permits the employee to repay the outstanding loan and avoid a default on the loan and the related income tax by repaying the loan the individual owed when their employment terminated no later than the due date for the individual's income tax return for the tax year in which their employment terminated. (For example, if an employee terminates on December 15, 2018, he must repay his plan loan to the IRA where he rolled his plan account over to by April 15, 2019.) *The law did not alter the retirement plan's obligation to report the distribution to the employee and the deemed distribution of the outstanding loan and related default to the IRS and to the individual on a Form 1099.*

Tax reform also did not explain how the plan or IRA receiving the rollover will know that an amount paid by an employee will be one of these special "plan loan offset amounts" and eligible to be accepted as a rollover. We can only wait to see how guidance deals with the administrative issues. This applies to loan offset amounts treated as distributed after 2017, or for any employee who terminates with a loan owed to the plan if the distribution occurs after 2017. This will be a challenge for record-keeping until guidance is provided to explain how to implement this. Presumably there will be guidance on how an employee should reconcile the retirement plan's reporting and their delayed rollover of the loan repayment under this provision on their federal income tax returns. Guidance is also necessary for employers to be able to answer employee questions.

Fringe Benefits and Tax Deductions

A number of the changes in tax reform related to the tax deduction employers had historically taken for certain fringe benefits. Fringe benefits in this context cover transportation expenses, entertainment expenses (tickets for entertainment or sporting events), employer-provided meals and employer-provided fitness facilities.

Transportation/Commuting Benefits for Employees

First, the *income tax exclusion for emplo*yees for qualified bicycle commuting expenses will not apply to any reimbursement paid after 2017 and before 2026. In a separate section, the law also amended the deduction rules to provide that *an employer may not receive a deduction for any qualified transportation fringe benefit under Code section 132(f) provided to an employee, unless the transportation is provided for the safety of the employee.* This means an employer may not deduct the cost of public transportation passes provided to employees and parking for employees, but at the same time the exclusion from the employee's income for such transit passes and parking still applies. Note that a change in tax treatment does not impact whether an employer subject to a state or local commuting, parking or ride sharing mandate must still comply with the state and local mandates. It only impacts the federal income tax deduction for the employer related to such amount under the Internal Revenue Code ("Code').

Entertainment Expenses and Recreation Expenses

An employer's deduction for expenses incurred for entertainment, amusement and recreation is generally denied, including facilities used in connection with such activities, for amounts incurred or paid after 2017, unless one of the exceptions applies. This includes dues with respect to clubs organized for business, recreational or amusement according to the Conference Report, which means it may impact the tax deduction for certain items that may be required to be paid under executive employment agreements This means business entertainment expenses (e.g., sporting event tickets, theater tickets) are not deductible, unless an exception applies. (The House Committee Report also included employer on-site fitness centers as being part of the recreational category. This was not altered in the final Conference Report, and it was also not addressed directly in the Senate Amendment. So there remains a question of whether and how this deduction denial applies to an on-site fitness facility.) The general denial of deduction does not apply if the employees are taxed on the value of the recreation, or if the facilities are made available by the taxpayer to the general public. (Note, opening an on-site employee only fitness center to the public may result in state or local licensure laws applying). As always, each new provision brings more questions than answers.

For tax exempt employers, there is an additional twist because loss of a tax deduction has no teeth for an employer whose income is not subject to federal income tax. *Tax reform added a new provision in the unrelated business income rules that increases the tax exempt entity's unrelated business income ("UBI") subject to the unrelated business income* *tax ("UBIT") for any fringe benefit provided to employees for which a deduction is disallowed under Code section 274.* This means that tax exempt employers who provide access to their on-site fitness center to employees at no cost or provide qualified transportation fringe benefits (e.g., transit passes or parking) will have their UBI increased for such expenses that would be nondeductible if they were a taxable entity (assuming no exception applies to permit a deduction). Tax exempt employers will potentially face UBIT related to such increase in their UBI. This is effective after 2017.

Expenses for Meals Provided to Employees

Previously 50% of the cost of employer-provided meals was not deductible. Now they will be treated like entertainment expenses and generally not be deductible. However, for some meal expenses there may still be an exception that will apply, such as meals served during a business meeting of employees. Beginning in 2018 meals provided at an on-site facility will still be subject to the 50% tax deduction limit; and beginning in 2026, there will be no deduction for meals provided either for the convenience of the employer or at an employer's on-site eating facility. Tax reform did not change the two provisions permitting employees to exclude such meals from their income, if such meals and employees met the requirements.

Employee Achievement Awards

Employee achievement rewards cannot be deducted if they are paid in cash, gift cards or similar reward cards or if they are vacations, meals, lodging, tickets to the theater or sporting events, stocks, bonds or other securities or similar items. Apparently this was intended to codify the IRS's current enforcement position. Employee achievement awards may still permit employees to select amongst personal property from a list of employer- selected items as achievement awards (e.g., pick the clock or the plaque). The codification of the IRS's position on what can be an employee achievement award in order for the employer to take a tax deduction is effective for amounts paid or incurred after 2017.

Employee Sexual Harassment or Sexual Abuse Settlements

An employer cannot deduct the amount paid for any settlement or payment related to sexual harassment or sexual abuse claim or the related attorney's fees, if the settlement or payment is subject to a nondisclosure agreement and the amount is paid or incurred on or after December 22, 2017 (the date of enactment). It is not clear how or if this might impact severance/separation agreements with departing employees by which the employee waives or releases all claims against the employer, which may or may not include any Title VII claims and which frequently include nondisclosure provisions. Many such separation/severance agreements are used to reduce litigation risk. In the absence of guidance to the contrary and in the absence of a pending sexual harassment or sexual abuse claim, there is an argument that such common tools are not settling any such claim and should not be impacted. Guidance on this provision should be watched to determine its final scope. A footnote to a recent National Labor Relations Board order also called on an employer to consider the legality of confidentiality clauses in separation agreements for former employees and a number of States have legislative efforts addressing confidentiality clauses in the context of separation or settlement agreements, so there are a number of fronts to watch related to separation agreements.

Paid Family and Medical Leave Tax Credit (but Only if You Provide It Voluntarily)

For a number of years, various state and local governments have imposed requirements for a local, paid family and medical leave counterpart. Tax reform now permits employers who implement their own paid family and medical leave voluntarily (in locations where the state and local laws do not mandate such paid leave) to obtain a federal tax credit for providing the benefit on a voluntary basis. The percentage of the tax credit varies by how much of the employee's compensation is replaced by the paid family and medical leave. An employer must have a written policy for this leave and because it is different from federal Family and Medical Leave Act requirements, it will require a separate policy and separate administrative scheme. For employees to qualify, the employee must have been employed by the employer for one year or more, and the employee's compensation must not exceed 60% of the Code's retirement plan highly compensated employee dollar limit for the year (60% of $120,000 in 2018). If an employer provides paid leave for multiple reasons that do not qualify as reasons for a federal Family and Medical Leave Act ("FMLA") leave (e.g., under a paid time off program), then such non-FMLA qualifying leave's payments do not count toward the leave pay for which the tax credit is available. An employer desiring to avail itself of this tax credit needs to start planning and developing the policies, administrative scheme and records for this tax credit which comply with the new statute's requirements (separate and apart from FMLA requirements) and identify which employees might not be eligible due to the state and local law paid leave mandates.

Executive Compensation- 162(m) Compensation Limit

The companies subject to the Code section 162(m) limit on the compensation deduction for what are generally the top five highest paid executives of certain companies with publicly traded securities were expanded to include more companies, and the compensation subject to the $1,000,000 deduction limit was also expanded to subject commissions and performance-based compensation to the deduction limit. The employees covered by this limit now clearly include not only the CEO but also the CFO. Since many compensation arrangements or plans are developed with long term corporate goals and strategies in mind, it may not be possible to make changes to compensation strategies that can be effective as quickly as the new statutory provisions. Many of the details in how this will apply still need to be worked out through the guidance process. The tax reform changes apply after 2017.

While the deduction limitation is effective for calendar year taxpayers first in 2018, companies are already qualifying their financial reporting and disclosures for the impact of this change on the compensation shown as deductible in their annual financial reports and particularly in the Compensation Discussion and Analysis.

Tax Exempt Executive Compensation- 162(m) Like Limit Applied to Tax Exempt Employers with an Excise Tax Penalty Instead of Loss of the Tax Deduction

Tax exempt charitable organizations are now also limited in the compensation they can pay to executives who are one of the five highest paid employees of the organization (the “High 5”) to no more than $1,000,000 per year. The High 5 is determined by only counting pay that is not pay for medical services (i.e., highly paid physicians providing medical services are not part of the High 5). Payment of compensation to one of the High 5 in excess of $1,000,000 per year results in the organization paying an excise tax of 21% of the amount in excess of the limit. This new tax potentially applies to payments that occur on termination of employment, referred to in the statute as “parachute payments.” (Parachute payments in this context are not the same as under the Code section 280G change in control parachute payments). A parachute payment subject to the excise tax for a tax exempt entity is similar to the parachute payment concept in a for-profit entity as the amount subject to the excise tax is measured by the amount by which the parachute payment exceeds 3 times a “base amount”. The law aggregates related entities in calculating the limits. The law does not apply to payments made under qualified retirement plans, annuity contracts under Code section 403(b) or Code section 457(b) plans. (There is no exemption for amounts paid under nonqualified deferred compensation plans under Code section 457(f), and such payments would be subject to the limit). This new limitation applies after 2017. The full details of each situation should be analyzed under the statute, and more clarification will be needed in the regulations to fully define the scope and implications for tax exempt entities.

New Type of Equity Grants

Tax reform also gave us a new type of equity grant for employers who do not have publicly traded securities, have not had publicly traded securities, and who want to grant the equity grants on a nondiscriminatory basis to at least 80% of the full-time qualified employees. A number of different types of employees are excluded from the individuals who qualify to receive these grants. Due to the requirements that the grants be issued to a very broad group and the fact that many of the executives, and shareholders with a 1% interest, are excluded from this type of grant, this new tool may not have broad use. This type of grant requires an election by the employee. It also requires the employer to adopt a written plan.

This alert is only intended to highlight select legal developments late in 2017 or early in 2018. It only addresses certain changes in the Tax Cuts and Jobs Act signed into law on December 22, 2017 that impact employers in their relationship with their employees. It is not intended to be a comprehensive update.

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