



Legal Alert: Tax Cut and Run: Employee Benefits Change Under the Tax Cuts and Jobs Act

November 6, 2017

On November 2, House Republicans released their sweeping [tax reform legislation](#), which contains numerous provisions that will have significant impacts on employee benefits and executive compensation. The bill is expected to evolve significantly in the coming weeks and months. The following is a brief summary of the legislation in the form in which it was released.

Retirement

- 401(k) Plans
 - Expands hardship distributions.
 - Requires the Internal Revenue Service (IRS) to eliminate the requirement in its regulatory safe harbor that the withdrawing participant suspend contributions for six months. (§ 1503)
 - Earnings on employee deferrals, as well as qualified non-elective and qualified matching contributions, would be eligible for hardship. (§ 1504)
 - Eliminates requirement to take any available plan loan before hardship withdrawal (§ 1504)
 - Plan loans outstanding at separation could be repaid to a rollover IRA as late as the income tax filing date for the year to avoid taxation. (§ 1505)
- Defined Benefit Plans
 - Effectively reduces the earliest normal retirement date to age 59.5. (§ 1502)
 - Frozen or closed defined benefit plans receive more flexibility to “cross test” so these plans can pass non-discrimination testing, as well as receive relief from benefits, rights, and features testing and the minimum participation rules. (§ 1506)

Deferred Compensation (§ 3801)

- Eliminates most deferred compensation. Compensation would be taxed when earned unless receipt is subject to a substantial risk of forfeiture (effectively imposes long-standing not-for-profit rules on for-profit entities).
 - Substantial risk of forfeiture is defined as receipt being conditioned on the future performance of substantial services. A non-compete,

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satisfaction of financial performance metrics, or occurrence of an event, such as an IPO, would not appear to qualify as a substantial risk of forfeiture.

- Severance arrangements would be considered deferred compensation.
- Applies to equity compensation such as stock options and stock appreciation rights (taxation at vesting, not exercise), but not incentive stock options.
- Supersedes §§ 409A and 457A, as well as, for tax-exempts, §§ 457(b) and 457(f).
- Existing deferred compensation as of December 31, 2017, would be subject to these new rules effective beginning in 2026, meaning that existing deferred compensation would all become taxable in 2025 unless subject to a substantial risk of forfeiture.

Section 162(m) \$1 Million Limit on Deductible Compensation (§ 3802)

- Applies to any employer with registered securities or that files period reports. Therefore, section 162(m) would not be limited to companies with public equity securities; public debt will subject the issuer to these limits.
- Eliminates the exception for performance-based compensation.
- The covered employee definition is expanded to again include the principal financial officer. Once an individual is a covered employee, the individual remains a covered employee as long as the individual is employed by the employer.

Tax-Exempt Employers (§ 3803)

- New 20% excise tax payable by the employer on:
 - Compensation in excess of \$1 million to its five highest-paid employees.
 - Separation pay in excess of three times the base amount (similar to current section 280G golden parachute rules) for the five highest-paid employees, regardless of whether there is a change in control.

Fringe and Other Benefits

- More benefits are taxable, including:
 - Tuition assistance (currently up to \$5,250) (§ 1204)

- Reimbursement of moving expenses (§ 1405)
- Employee achievement awards (e.g., gold watch ceremony) (§ 1403)
- Dependent care assistance, i.e., would eliminate dependent care assistance plans (currently up to \$5,000) (§ 1404)
- Adoption assistance (currently up to \$13,570) (§ 1406)
- Employer-provided housing in excess of \$50,000 per year for single employees and \$25,000 for married employees, and the non-taxability would be phased out for employees earning more than \$120,000 (§ 1401)
- Long-term care premiums in excess of age-based limits (\$200-\$2,500 per year) (§ 1308)
- The employer would not be entitled to a deduction for certain non-taxable benefits. (§ 3307)
 - Applies to various non-taxable fringe benefits, including transportation and parking fringe benefits, on-premises gyms, club dues (including business clubs) and other benefits personal in nature involving personal services or property not directly related to the employer's trade or business.
 - Working condition fringe benefits continue to be deductible.
- Eliminates personal deductions for expenses of being an employee. Nevertheless, the working condition fringe benefit rules will continue to apply as if the old rules were in effect. (§ 1312)

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