Larry's Tax Law

Decoding the Tax Cuts and Jobs Act - Part VI: Employment and Fringe Benefit Related Provisions

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BACKGROUND

The Tax Cuts and Jobs Act ("TCJA") creates, modifies or eliminates a number of employment and employee fringe benefit related provisions of the Code. Both employers and employees need to be aware of these changes. Accordingly, this installment of our ongoing review and analysis of the TCJA focuses on these employer and employee fringe benefit provisions.

KEY EMPLOYMENT AND FRINGE BENEFIT CHANGES

Meals and Entertainment Expenses

Prior Law

Prior to the TCJA, businesses could deduct up to 50% of meals and entertainment ("M&E") expenses that were directly related to the active conduct of the trade or business. However, subject to limited exceptions, no deductions were allowed for membership dues with respect to clubs organized for business, recreational or social purposes. The exceptions included the provision of a 100% deduction in the case of expenses: (i) includable as employee wages or as non-employee compensation; or (ii) for employer-provided meals that qualified under the "*de minimis*" or "for the convenience of the employer" fringe benefit rules (e.g., employer-operated on-premises cafeterias).

Lawmakers perceive that M&E deductions have been historically abused by taxpayers. Although subject to a 50% limitation, enacted as part of the Tax Reform Act of 1986, questions often arose about whether the expenses were sufficiently business related to qualify for deduction, and substantiation has been a common issue in IRS audits.

TCJA Changes

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The TCJA eliminates the subjective determination of whether entertainment deductions are business related. It does so by amending IRC Section 274 to totally eliminate any deduction for business-related entertainment expenses incurred after December 31, 2017! However, the TCJA retains the current 50% deduction for business-related meals (i.e., food and beverage expenses), including meals consumed by employees on work-related travel.

There has been some confusion in the media surrounding this provision because previously expenses for meals were generally treated in the same manner as entertainment expenses. Today, the old framework for meal expenses remains in effect, but the ability to deduct entertainment expenses is totally eliminated.

As a result of this change to the Code, we suspect disputes relative to whether taxpayer activities constitute "entertainment" will flourish. Although Treasury may issue regulatory guidance, creative taxpayers will likely push any regulatory parameters in this regard to the maximum.

The TCJA applies new limits to employer-provided meals that otherwise qualify under the "*de minimis*" or "for the convenience of the employer" fringe benefit rules. For amounts incurred and paid after December 31, 2017, the TCJA now applies the 50% limitation to expenses of the employer associated with providing such meals. The employee income exclusions are unchanged, but the employer can no longer deduct all of its expenses in providing such meals. Those expenses are now subject to the same 50% limit as other business meals. Be aware – after December 31, 2025, employer-provided meal expenses will no longer be deductible. In essence, the TCJA creates a two-step phase-down of the pre-TCJA 100% deduction for qualifying employer-provided meals. There's a 50% limitation that applies through 2025 and, thereafter, such costs are non-deductible. So much for tax simplification!

Employee Compensation Deductions

Prior Law

Prior to the TCJA, publicly traded corporations were subject to a limitation under IRC Section 162(m) that disallowed deductions for compensation paid to certain specified executives (i.e., "covered employees") in excess of $1 million annually. There were, however, exceptions for: (i) compensation payable in the form of commissions; (ii) qualifying performance-based compensation (e.g., stock options); (iii) retirement plan contributions; and (iv) amounts otherwise excludable from the employee's gross income (e.g., non-taxable fringe benefits). Under this framework, "covered employee" included the chief executive officer ("CEO") and the three most highly compensated officers other than the CEO.

TCJA Changes

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The TCJA modifies these rules. For tax years beginning on or after January 1, 2018, the exceptions for commissions and performance-based compensation are repealed, and the definition of "covered employee" is expanded to include the CEO, the chief financial officer ("CFO") and the three other highest compensated officers. Moreover, if an individual is a "covered employee" for any tax year after December 31, 2016, he or she remains a "covered employee" for all future years.

The application of this amendment to IRC Section 162(m) is unsuspectingly broad. The legislative history indicates it is intended to include years during which the individual "covered employee" has terminated employment and years after he or she has died! Thus, this rule is specifically aimed at deferred compensation payable to executives (or their spouses and beneficiaries) well after the executive has retired or died.

There's a transition rule under which the TCJA changes do not apply to any compensation paid under a written employment agreement in effect on November 2, 2017, that has not been materially modified after that date. Compensation paid pursuant to a plan (e.g., a nonqualified deferred compensation plan) qualifies for the transition rule if the right to participate in the plan was part of a written binding contract in effect on November 2, 2017. The fact that a plan was already in existence on November 2, 2017 is not sufficient by itself to qualify. What is a "material" modification? Lots of unanswered questions exist. Caution is advised.

New Credit for Employer-Paid Family Leave

The TCJA added a new credit, found in IRC Section 45S, for employer-paid family or medical leave. Eligible employers may claim a general business credit equal to 12.5% of the amount of wages actually paid to qualifying employees during any period in which such employees are on family or medical leave, provided the employer pays the employee at least 50% of his or her normal hourly wages while on leave. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the paid leave rate exceeds 50% of the employee's normal hourly wages. A maximum of 12 weeks of family or medical leave may be taken into account with respect to any employee for a tax year.

An "eligible employer" is an employer that maintains a written policy that allows all qualifying full-time employees (based upon customary employment of 30 or more hours per week) at least two weeks of annual paid family or medical leave (defined in reference to qualifying FMLA leave), and that allows all part-time qualifying employees a commensurate amount of leave on a pro rata basis. For purposes of this requirement, leave paid for by a state or local government is not taken into account.

A "qualifying employee" means any employee (as defined under the Fair Labor Standards Act, which provides some exceptions for public and agricultural employees) who: (i) has been employed by the employer for one year or more; and (ii) for the preceding year, had compensation less than 60% of the compensation threshold for "highly compensated employees" under IRC Section 414(q). In 2018, that threshold is $120,000; so 60% of that amount would be $72,000.

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Note: Employer-provided paid vacation, personal or sick leave is not considered to be family or medical leave for purposes of the credit. Also, certain FMLA protections (e.g., non-discrimination, non-retaliation rules) apply to employers who take the credit, but otherwise aren't subject to the FMLA. Employers also cannot take both a credit and a deduction with respect to the wages for which the credit is claimed.

The TCJA gives the Secretary authority to determine whether an employer or an employee satisfies the applicable requirements for an eligible employer or qualifying employee, based on information provided by the employer.

The new credit is effective for tax years beginning after December 31, 2017; however, it sunsets quickly, as it does not apply for wages paid in tax years beginning after December 31, 2019. Apparently, Congress desired to institute the credit as a means of motivating employers to provide paid family leave in excess of any existing paid vacation, personal or sick leave programs. Many employers find it hard to take away benefit plans once they are in place. Time will tell whether the credit is effective in motivating employers to adapt these benefit plans and retain them after 2019.

Other Fringe Benefits Programs

Employee Achievement Awards

Prior Law

Under prior law, the value of certain employee achievement awards could qualify for an exclusion from the recipient's gross income, and a corresponding deduction by the employer. Among other things, the qualifying awards had to consist of tangible personal property received as part of a meaningful presentation in recognition of a safety or length of service achievement. The exclusion was generally limited to $400, or $1,600 in the case of an award under a "qualified plan."

TCJA Changes

The House bill had proposed eliminating both the employer deduction and the employee income exclusion; however, the final result is not so drastic. The TCJA simply clarifies the current framework by providing a definition of "tangible personal property." Under this definition, "tangible personal property" excludes cash, cash equivalents, gift cards, gift coupons or gift certificates (other than arrangements that only provide a right to select items from a limited array of pre-selected or pre-approved items of tangible personal property), or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. The text of the joint House and Senate conference report notes that "no inference is intended that this is a change from present law and guidance."

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Apparently, Congress was targeting employer abuses of what constitutes "tangible personal property." Given that gift cards and other cash equivalents have become commonplace, Congress felt this "clarification" was enough. So, with this clarification, the old law continues.

Transportation Fringe Benefits

Prior Law

Under prior law, IRC Section 132 provided employees an exclusion from gross income for qualified transportation fringe benefits provided by an employer. Qualified transportation fringe benefits include qualified parking (at or near the employer's premises or at or near a location from which the employee commutes to work by public transit), transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. Such benefits were also deductible to the employer as employee compensation.

TCJA Changes

The TCJA makes several sets of interrelated changes to this statutory framework. First, it eliminates the employer deduction for: (i) qualified transportation fringe benefits; and (ii) any expense, or any payment or reimbursement, incurred in providing transportation between the employee's residence and place of employment, except as necessary for ensuring the safety of an employee.

Second, to keep the playing field level between taxable and tax-exempt employers, the TCJA provides that exempt organizations must treat any nondeductible amounts as unrelated business taxable income (i.e., UBTI). Since tax-exempt organizations would be unaffected by loss of the deduction, they are actually taxed on the value of the benefit as a means of placing them on the same plane as taxable employers.

The good news is that, except as discussed below, the TCJA does not modify the existing income exclusion for the employees receiving qualified transportation fringe benefits.

The bad news for cyclists is that the TCJA temporarily eliminates the income exclusion for qualified bicycle commuting reimbursements (up to $20 per month). The exclusion is suspended for tax years beginning after December 31, 2017, and before January 1, 2026.

Moving Expenses

Prior Law

Under prior law, IRC Section 217 allowed individuals an above-the-line deduction for moving expenses paid or incurred in connection with commencing a new job in another location. This applied to both employees and self-employed individuals. To qualify, the new workplace generally had to be at least 50 miles farther from the taxpayer's former residence than the

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former workplace. There was a related income exclusion under IRC Section 132(g) for qualified moving expense reimbursements paid by an employer.

TCJA Changes

The TCJA temporarily eliminates both the deduction and the exclusion for most taxpayers. For tax years beginning after December 31, 2017, and before January 1, 2026, the deduction and exclusion are only available for active duty members of the U.S. Armed Forces (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

This change will impact employers as well as employees and self-employed individuals who move for a new job. Employees and self-employed individuals will lose the benefit of the deduction, and to the extent an employer reimburses an employee for moving expenses, the employee has additional gross income. (The employer deduction remains unchanged.)

This changes the calculus related to any work-related move, by effectively increasing the cost of the move to the employee. Employers that provide reimbursements could potentially make the employee whole by providing an additional "tax gross up" payment to the employee to offset the additional tax burden (which is, of course, also taxable). However, doing so puts an additional cost burden on the employer. It will be interesting to see the effects of this change.

A Word About Repeal of the ACA Individual Mandate

The TCJA has also eliminated the "individual mandate" provision of the Affordable Care Act by reducing the amount of the "individual shared responsibility" penalty tax imposed under IRC Section 5000A to zero, effective as of January 1, 2019. (It still applies for 2018.) There has been a fair bit of confusion surrounding this change.

This change only applies to the "individual mandate" under IRC Section 5000A, which only applies to individual taxpayers, not employers. The TCJA did not change or eliminate the "employer mandate" tax penalties under IRC Section 4980H. Employers still continue to offer affordable qualifying health coverage to a sufficient number of their full-time employees to avoid penalties under IRC Section 4980H.

CONCLUSION

The TCJA impacts a number of long-time employment-related tax benefits. These changes will affect a broad swath of employers and employees. Employers should review their compensation and benefit programs to determine the potential impact, and to ensure they are complying with the TCJA's new framework.

Stay tuned for further review and analysis of other provisions of the TCJA.

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