

# Executive Compensation, Employee Benefits and ERISA Alert

January 8, 2018

## President Trump Signs Tax Reform Bill into Law

On December 15, 2017, the House and Senate conference committee agreed on the terms of the final tax reform bill, previously referred to as the “Tax Cuts and Jobs Act” (the “Act”), which was subsequently approved by both houses along party lines. The bill was signed into law by President Trump on December 22, 2017. Below is a summary of the material executive compensation and employee benefits-related provisions of the Act.

### Compensation Deduction Limit for Public Companies

The Act repeals the exceptions to the \$1 million deduction limitation for commissions and qualified performance-based compensation under Section 162(m).<sup>1</sup> Therefore, effective January 1, 2018, compensation paid to a “covered employee” in a taxable year that exceeds \$1 million would not be deductible even if the compensation were a commission or qualified performance-based compensation. The Act also revises the definition of “covered employee” to include the previously excluded Chief Financial Officer (in addition to the Chief Executive Officer and the other three highest paid employees) and extends the applicability of Section 162(m) to corporations that are required to file reports under the Securities Exchange Act of 1934, as amended, even if their stock is not publicly traded (e.g., because they have public debt or are foreign companies that are publicly traded through ADRs). Finally, if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years, including after termination of employment. The new rule does not apply to compensation that is provided pursuant to a written binding contract that was in effect on November 2, 2017, and that was not modified in any material respect on or after that date.

### Qualified Equity Grants

The Act adds a new subsection under Section 83 that permits eligible employees to elect to defer recognition of income for up to five years after a stock option is exercised and/or a restricted stock unit is settled. This limited relief applies to only equity arrangements of nonpublic corporations that have broad employee participation (generally 80 percent non-de-minimis participation). In addition, this limited relief does not apply to the Chief Executive Officer, the Chief Financial Officer or certain other highly compensated employees. This new provision may be useful for private companies who wish to avoid having employees hold actual shares prior to a liquidity event. However, due to certain limitations in the rules, its utility may be limited.

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<sup>1</sup> “Section” references are to the Internal Revenue Code of 1986, as amended.

## **Excess Compensation Paid by Tax-Exempt Organizations**

Effective as of January 1, 2018, the Act imposes a 21 percent excise tax (the new corporate tax rate) on compensation of more than \$1 million paid by a tax-exempt organization to any of its five highest paid employees (including former employees). The excise tax also applies to excess parachute payments made by a tax-exempt organization to covered employees whose employment is terminated during the year. An excess parachute payment generally includes payments with an aggregate present value of three (or more) times the covered employee's base compensation that is contingent on the employee's separation from employment.

## **Retirement Plans**

With respect to traditional IRAs that are converted into Roth IRAs, individuals are no longer permitted to recharacterize (i.e., unwind) a Roth IRA conversion. Other types of re-characterizations continue to be permitted. This provision is effective as of January 1, 2018.

Under the Act, employees whose defined contribution retirement plan terminates or who separate from employment while they have plan loans outstanding will have until the due date (including extensions) for filing their federal income tax return for that year to roll over the loan balance to another retirement plan or an IRA in order to avoid the loan being taxed as a distribution.

This provision is effective as of January 1, 2018.

## **Qualified Moving Expense Reimbursements**

For taxable years 2018 through 2025, the Act suspends the exclusion from an employee's income for employer-provided qualified moving expenses, except in the case of members of the U.S. Armed Forces on active duty who move pursuant to a military order. The suspension of the exclusion sunsets after 2025.

## **Qualified Transportation Fringe Benefits**

The Act repeals the employer's deduction for qualified transportation fringe benefits, including qualified parking, transit passes and vanpool benefits, except for expenses that are "necessary for ensuring the safety of the employee" between the employee's residence and workplace. The Act does not specify what expenses qualify as necessary to ensure an employee's safety. This provision applies to amounts paid or incurred after December 31, 2017.

## **Qualified Bicycle Commuting Reimbursements**

For taxable years 2018 through 2025, the Act suspends the exclusion from an employee's income of reimbursements for qualified bicycle commuting expenses. The suspension of the exclusion sunsets after 2025. Employers will be able to deduct qualified bicycle commuting reimbursements until January 1, 2026.

## **Employee Achievement Awards**

The Act clarifies that, in order to be excludible from an employee's income, an employee achievement award must be in the form of "tangible personal property," which generally does not include cash, cash

equivalents, gift cards, gift coupons or gift certificates (with certain exceptions), or vacations, meals, lodging and other similar items. The provision applies to amounts paid or incurred after December 31, 2017.

### **Deduction for Entertainment Expenses**

For amounts paid or incurred after December 31, 2017, the Act repeals the deduction with respect to (1) entertainment, amusement and recreational activities; (2) membership dues relating to any club organized for business, pleasure, recreation or other social purposes; or (3) a facility or portion thereof used in connection with any of the above items.

Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the Act expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets the requirements for de minimis fringe benefits and for the convenience of the employer. Any such amounts that are incurred and paid after December 31, 2025, are not deductible (i.e., the provision sunsets).

### **Inflation Adjustments**

The Act replaces the use of the CPI-U (the Consumer Price Index for All Urban Consumers) with the C-CPI-U (the Chained Consumer Price Index for All Urban Consumers) for purposes of indexing for inflation certain dollar thresholds (e.g., IRAs, flexible spending accounts and health savings accounts). Increases in dollar thresholds should increase at a slower rate, since the C-CPI-U tends to rise slower than the CPI-U.

### **Affordable Care Act Individual Mandate**

The Act reduces the penalty (imposed on individuals) for not purchasing minimum health coverage to zero beginning January 1, 2019.

## Contact Information

If you have any questions regarding this alert, please contact the Akin Gump lawyer with whom you usually work or:

**Bruce E. Simonetti**

[bsimonetti@akingump.com](mailto:bsimonetti@akingump.com)

212.872.8023

New York

**Robin M. Schachter**

[rschachter@akingump.com](mailto:rschachter@akingump.com)

310.728.3363

Los Angeles

**Rolf Zaiss**

[rzaiss@akingump.com](mailto:rzaiss@akingump.com)

212.872.1050

New York

**Michael Gerald**

[mgerald@akingump.com](mailto:mgerald@akingump.com)

213.254.1206

Los Angeles

**Aimee M. Adler**

[aadler@akingump.com](mailto:aadler@akingump.com)

212.872.8060

New York