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BRIEFING
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BENEFIT PROVISIONS IN TAX REFORM LAW

On December 22, 2017, President Trump signed a sweeping tax reform bill into law. There has been significant reporting detailing the changes the bill brings to corporate and individual tax rates, deductions and exclusions; however, aside from the impact on the Affordable Care Act (ACA), less attention has been given regarding changes to the tax treatment of employee benefits. This *Briefing* will summarize those changes.

HEALTH INSURANCE

While the biggest change was the repeal of the individual mandate under the ACA, there were other changes to the tax treatment of health insurance benefits and medical expenses.

- **Individual Mandate** - The bill eliminates the penalty on individuals who fail to maintain health coverage under the individual mandate of the ACA. That change will go into effect on January 1, 2019. An analysis prepared by the Congressional Budget Office found that eliminating the individual mandate would result in a 13,000,000 reduction in the number of Americans with insurance and would cause the cost of coverage on the individual market to rise 10% in the coming decade. There are also concerns that a portion of the increased cost could spill over into the group market.

- **Medical Expense Deduction** - The individual medical expense deduction was temporarily modestly enhanced. For 2017 and 2018, medical expenses above 7.5% of adjusted gross income ("AGI") qualify for the deduction. After 2018, only amounts above 10% of AGI will be deductible, as under existing law.

- **HRAs/HSAs/FSAs** - The tax treatment of Health Reimbursement Arrangements, Health Savings Accounts, and Flexible Spending Accounts (both Health FSAs and Dependent Care FSAs) was unchanged by the tax bill.

RETIREMENT BENEFITS

There were a number of changes to the tax treatment of certain retirement benefits.

- **Length of Service Awards** - The new law will modify the rules applicable to length of service award programs for bona fide public safety volunteers, including increasing the aggregate amount of length-of-service awards that may accrue for a bona fide volunteer with respect to any year of service.

- **Defined Contribution Plan Loan Rollovers** - The new law will amend the period of time during which a plan participant may rollover a plan loan in the event an employee separates from service, or if the plan terminates while a loan is outstanding. The time allowed under current law is 60 days. That would be extended to the date the employee's tax return is due.

- **Recharacterization of Roth IRAs** - The new law will prohibit the recharacterization of a Roth IRA contribution as a traditional IRA contribution.

- **Early Withdrawal Penalty** - The new law will provide tax relief to areas in which a major disaster was declared by the President in 2016. (Note: while six major disaster declarations have been made in California in 2017, none were made in 2016.) In those areas impacted by this relief, there would be an exception to the 10% early withdrawal tax for a distribution from a qualified retirement plan, 403(b) plan or IRA.

Fringe Benefits

- **Entertainment** - The bill eliminates the deduction for entertainment, amusement or recreation that is directly related to the active conduct of the taxpayer's trade or business. It disallows the current law deduction for expenses relating to entertainment tickets and to skyboxes to the extent that the expenses are included as compensation to an employee on the employer's tax return.

- **Meals** - The bill allows a deduction for 50% of food and beverage expenses associated with operating a trade or business. It also provides a 50% limit to expenses for food and beverages provided to employees through a facility operating for the convenience of the employer (e.g. an on-site employee cafeteria) through 2025. After 2025, it eliminates the deduction for on-site meals.

- **Qualified Transportation** - The bill eliminates the current business deduction for qualified transportation fringes provided to employees, except as necessary for the safety of an employee in commuting between home and work. The deduction for bicycle commuting reimbursements is suspended for tax years from 2018 through 2026. This change does not affect some state and local laws that may mandate commuting benefits. For example, the California law that mandates that Bay Area employers with 50 or more employees provide commuter benefits to their employees remains unchanged. Mass transit and parking benefits will continue to be tax-exempt to employees. Employers affected by state and local commuter mandates may consider doing so through an employer-sponsored salary deduction program.

- **Employee Achievement Awards** - The bill eliminates the deduction for employee achievement awards paid in the form of cash, cash equivalents, gift cards, gift coupons or gift certificates (with some limitations), paid vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and similar items.

- **Moving Expenses** - The bill suspends the exemption from income and the employer's deduction for employer reimbursement of qualified moving expenses for tax years from 2018 through 2025.

Paid Family Leave

The new law put in place a federal tax credit for employers that provide paid family and medical leaves to their employees who earn less than $72,000 per year. Under the new law, employers that provide at least two weeks of leave at a minimum 50% of the employee's regular earnings are eligible for a tax credit of 12.5% to 25% of the cost of each hour of paid leave. To claim the credit, an employer would have to offer paid leave to full-time and part-time workers who have worked for the employer for at least one year. This tax credit is effective beginning in 2018 and will sunset after 2019 unless reauthorized by Congress.

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Executive Compensation

Two provisions in the tax law impact executive compensation.

- **Cap on Deductions for Senior Executives** - Under current law, publicly held companies are prohibited from deducting more than $1 million per year in compensation paid to senior executive officers. Prior to the passage of the new tax law, commissions and performance-based pay were exempt from this limit. The new law eliminates that exemption and expands the reach of this limit to include CEOs, CFOs and the three highest-paid employees of the company.

- **Nonprofit Excise Tax** - The new law sets a 20% excise tax on the compensation of the five highest-paid employees who earn more than $1 million at nonprofit employers (including 501(c)(3) and 501(c)(6) organizations.)

What's Next

One of the Senators who had reservations about the tax reform package was Susan Collins (R-Maine.) To secure her vote for tax reform, three things were reportedly promised regarding health insurance.

- Congress would vote on the legislation developed by Lamar Alexander (R-Tennessee) and Patty Murray (D-Washington) to stabilize the individual market.

- Congress would take up the bill Senator Collins has coauthored with Senator Bill Nelson (R—Florida) to provide $4.5 billion in federal reinsurance funding over 2018 and 2019. Congress would prevent automatic Medicare spending cuts that could occur under current budget rules.

- The House Ways and Means Committee also introduced a group of bills on December 12, 2017 which would delay the imposition of the Cadillac tax, the health insurance tax on carriers, the medical device tax and several other ACA taxes.

Please contact your Keenan HealthCare Account Manager for questions regarding this *Briefing*.