

A Moving Target: Tax-Qualified Plans and Other Employee Benefits

The House and Senate propose changes to the tax rules governing retirement plans and other employee benefits.

11.17.17

By Pillsbury's Executive Compensation & Benefits Team

Tax reform, including changes to retirement plans, health and welfare plans, and fringe benefits, is well underway as the House and Senate move forward with legislative efforts. On November 16, 2017, the House passed its tax reform bill, the Tax Cuts and Jobs Act. The Senate proposal released on November 9, 2017 was revised on November 14, 2017 and approved by the Senate Finance Committee late on November 16, 2017.

TAKEAWAYS

House passes the Tax Cuts and Jobs Act with substantive changes to the tax rules affecting retirement plans and fringe benefits.

Currently, the Senate's proposal is similar to the House bill but does not expand the availability of in-service distributions from 401(k) plans or eliminate the tax-advantaged status of dependent care FSAs.

Employers should stay informed about the emerging changes, as these changes may require swift action by year end.

Background

On November 2, 2017, the House of Representatives introduced its long-rumored "Tax Cuts and Jobs Act." The House Ways and Means Committee approved various amendments to the bill on November 9, 2017 and sent the revised bill to the full House for a vote. The House passed the revised bill on November 16, 2017 (the "House Bill").

Also on November 9, 2017, the Senate Finance Committee released its proposal for a tax reform bill, "Description of the Chairman's Mark of the 'Tax Cuts and Jobs Act.'" The Chairman's mark was significantly modified on November 14, 2017 and was approved with minor additional modifications by the Senate Finance Committee on November 16, 2017 (collectively referred to as the "Senate Proposal"). As of the date of this alert, the Senate Finance Committee has not released a proposed tax bill.

If enacted as they currently stand, both the House Bill and the Senate Proposal would make certain minor changes to retirement plan benefits and would eliminate the favorable tax treatment of many treasured fringe benefits. Employer-sponsored health and welfare plan benefits would be left largely untouched. The House Bill and Senate Proposal are expected to evolve as they progress through the legislative process.

Proposed Laws

The table below summarizes the key retirement plan, health and welfare plan, fringe benefit, and employment tax provisions of the House Bill and the Senate Proposal.

RETIREMENT PLANS

Employee 401(k) Contributions

Current Law	<p>Employees may contribute up to \$18,500 (for 2018) pre-tax per year to their 401(k) plan accounts.</p> <ul style="list-style-type: none"> • Employees who are age 55 or older may make an additional \$6,000 pre-tax "catch-up contribution."
House Bill	<ul style="list-style-type: none"> • Preserves tax treatment of employee 401(k) contributions up to \$18,500. • Preserves tax treatment of catch-up contributions.
Senate Proposal	<ul style="list-style-type: none"> • Preserves tax treatment of employee 401(k) contributions up to \$18,500. • Preserves tax treatment of catch-up contributions.

In-Service Distributions

Current Law	<p>Defined contribution plans, including 401(k) plans, may permit employees who are age 59½ or older to take in-service distributions attributable to tax-deferred contributions.</p>
House Bill	<ul style="list-style-type: none"> • Preserves availability of in-service distributions. • Permits defined benefit plans (pension plans) to make in-service distributions to participants beginning at age 59½ for plan years beginning after 2017.
Senate Proposal	<ul style="list-style-type: none"> • Preserves availability of in-service distributions. • Does not adopt House proposal with respect to defined benefit plans.

Hardship Distributions

Current Law	<p>Defined contribution plans may permit employees who are less than 59½ years old to take hardship distributions if certain requirements are satisfied.</p> <ul style="list-style-type: none"> • Plans do not allow employees taking hardship distributions to make contributions to the plan for six months after the distribution. • Hardship distributions may not be made from earnings or qualified nonelective contributions ("QNECs").
House Bill	<ul style="list-style-type: none"> • Preserves availability of hardship distributions. • Requires the IRS to change its guidance to allow employees taking hardship distributions to continue making contributions to the plan for plan years beginning after 2017. • Permits employers to choose to allow hardship distributions from earnings and QNECs for plan years beginning after 2017.
Senate Proposal	<ul style="list-style-type: none"> • Preserves availability of hardship distributions. • Does not adopt House proposal to allow contributions during the six months following receipt of a hardship distribution.

RETIREMENT PLANS

Plan Loans

Current Law	Defined contribution plans, including 401(k) plans, are permitted to allow employees to take plan loans from their accounts. Employees who fail to timely repay loans are deemed to receive a taxable distribution in the amount of the outstanding loan. If a plan terminates or an employee separates from employment while a plan loan is outstanding, the employee has 60 days to contribute the loan balance to an IRA, or the loan is treated as a distribution.
House Bill	<ul style="list-style-type: none"> • Preserves current tax treatment for plan loans. • Permits employees whose plan terminates or who separate from employment with outstanding plan loans to contribute the loan balance to an IRA by the due date for filing their tax returns for that year in order to avoid the loan being taxed as a distribution for tax years beginning after 2017.
Senate Proposal	<ul style="list-style-type: none"> • Preserves current tax treatment for plan loans. • Same as House proposal.

Nondiscrimination Rules

Current Law	Employer-sponsored retirement plans must satisfy nondiscrimination rules designed to ensure that the plan does not favor highly compensated employees. For employers sponsoring both a defined contribution plan and a defined benefit plan, the nondiscrimination rules allow limited cross-testing between the two plans.
House Bill	Preserves nondiscrimination rules but allows expanded cross-testing between employers' defined benefit and defined contribution plans effective as of the date of enactment.
Senate Proposal	Preserves current nondiscrimination rules.

Individual Retirement Account ("IRA") Contributions

Current Law	Individuals may re-characterize contributions to a traditional IRA as a contribution to a Roth IRA (and vice versa).
House Bill	Disallows re-characterization of IRA contributions for tax years beginning after 2017.
Senate Proposal	Same as House proposal.

HEALTH AND WELFARE PLANS

Employer-provided health care benefits

Current Law	Employer-provided health care benefits, including medical, dental, and vision insurance that satisfy certain requirements are not includible employees' income. Employees may make tax-free contributions to help pay for their health care plan coverage.
House Bill	Preserves current tax treatment.
Senate Proposal	Preserves current tax treatment.

HEALTH AND WELFARE PLANS

Cadillac Tax

Current Law	Beginning in 2020, a 40% excise tax will be imposed on employers who offer high-cost employer sponsored plans. The tax will be imposed on the cost of health coverage that exceeds \$10,200 per year for individuals and \$27,500 for families.
House Bill	Preserves current tax treatment.
Senate Proposal	Preserves current tax treatment.

Health Savings Accounts ("HSA")

Current Law	Employees who participate in a high deductible health plan may make pre-tax contributions to an HSA. Employers may also make tax-deductible contributions to employees' HSAs; employees are not taxed on employer contributions. HSA funds are not taxable when used for certain qualifying medical expenses.
House Bill	Preserves current tax treatment. ¹
Senate Proposal	Preserves current tax treatment.

Archer Medical Savings Account ("MSA")

Current Law	Individual contributions to an MSA are excluded from income. Employer contributions are also excluded from income. Employers may take a deduction for employer contributions to MSAs.
House Bill	<ul style="list-style-type: none"> • Eliminates exclusion for all contributions to MSAs effective for tax years beginning after 2017. • Eliminates employer tax deduction for MSA contributions effective for tax years beginning after 2017.
Senate Proposal	Preserves current tax treatment.

FRINGE BENEFITS

Commuter Benefits

Current Law	Employers may provide qualified transportation fringe benefits to employees, including parking on or near the employer's business premises, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. Employers may deduct the cost of these benefits and these benefits are not taxable income to the employee. Employees who elect to contribute part of their compensation to these benefits may make contributions on a pre-tax basis.
House Bill	<ul style="list-style-type: none"> • Eliminates employer deduction for employer-paid transportation and parking fringe benefits effective for amounts paid or incurred after 2017. • Preserves income exclusion for employees.
Senate Proposal	<ul style="list-style-type: none"> • Same as House proposal. • Preserves income exclusion for employees.

FRINGE BENEFITS

Dependent Care Flexible Spending Accounts (“Dependent Care FSAs”)

Current Law	Employees may contribute up to \$5,000 per year on a pre-tax basis to a dependent care FSA sponsored by an employer to fund child care costs or expenses related to care for a disabled spouse or other dependent or an elderly or disabled parent.
House Bill	Eliminates dependent care FSAs for tax years beginning after 2022.
Senate Proposal	Preserves current tax treatment.

Employer-Provided Childcare Credit

Current Law	Employers may claim a tax credit equal to 25% of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The credit is limited to \$150,000 per tax year.
House Bill	Eliminates the employee child care tax credit for employers for tax years beginning after 2017.
Senate Proposal	Preserves current tax treatment.

Educational Assistance Programs

Current Law	Employer-provided education assistance is excluded from income. The exclusion is limited to \$5,250 per year and applies to both graduate and undergraduate courses.
House Bill	Makes employer-provided educational assistance program benefits fully taxable to employees for tax years beginning after 2017.
Senate Proposal	Preserves current tax treatment.

Housing and Meals

Current Law	Housing and meals provided to an employee for the convenience of the employer are excluded from an employee’s income if the meals are on the business premises of the employer and the employee is required to accept lodging on the premises of the employer as a condition of employment.
House Bill	Limits the exclusion for housing provided for the convenience of the employer to \$50,000 (\$25,000 for a married individual filing a joint return) and would phase out for highly compensated individuals (income of \$120,000 for 2017) at a rate of one dollar for every two dollars of adjusted gross income earned by the individual beyond \$120,000 for tax years beginning after 2017.
Senate Proposal	Disallows employer deductions for expenses associated with meals provided for the convenience of the employer on the employer’s premises or through an employer-operated facility for tax years beginning after 2025.

FRINGE BENEFITS

Moving Expenses

Current Law	Qualified moving expense reimbursements provided by an employer to employees are excluded from employees' income.
House Bill	Makes employer-provided moving expense reimbursements fully taxable to employees for tax years beginning after 2017.
Senate Proposal	Same as House proposal.

Employee Achievement Awards

Current Law	Employee achievement awards are excluded from employees' income. Employees are taxed to the extent that the cost or value of the award exceeds \$1,600 for qualified plan awards, and \$400 otherwise. The average award for all employees may not exceed \$400.
House Bill	<ul style="list-style-type: none"> • Makes employer-provided achievement awards fully taxable to employees for tax years beginning after 2017. • Permits employers to deduct the full amount of achievement awards, effective for tax years beginning after 2017.
Senate Proposal	Preserves current tax treatment.

Adoption Assistance

Current Law	Qualified adoption expenses paid by an employer to employees are excluded from the employees' income.
House Bill	Makes payments from adoption assistance programs fully taxable to employees for tax years beginning after 2017.
Senate Proposal	Preserves current tax treatment.

Entertainment Expenses

Current Law	Employers may deduct up to 50% of expenses relating to entertainment, amusement or recreation activities, or facilities (including membership dues with respect to such activities or facilities) if directly related to the active conduct of the employer's trade or business.
House Bill	<ul style="list-style-type: none"> • Limits deductible entertainment expenses to expenses for food or beverages and to qualifying business meals, with no deduction allowed for other entertainment expenses for tax years beginning after 2017. • If the entertainment involves only employees, the employer may deduct those expenses as a working condition fringe benefit subject to limitations under Internal Revenue Code Section 132.
Senate Proposal	<ul style="list-style-type: none"> • Similar to House proposal. • Permits employers to deduct 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel), and expands the 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes under Internal Revenue Code Section 132.

EMPLOYER TAXES

Employer-Paid Social Security ("FICA") Taxes

Current Law	Employers may claim a tax credit equal to the share of FICA taxes attributable to tips received from customers in connection with the provision of food or beverages, provided tipping is customary for that employer's customers.
House Bill	Reduces the tax credit to tips reported only above the current minimum wage rather than tips above \$5.15 per hour for tax years after 2017. All restaurants claiming the credit would be required to report to the IRS tip allocations among tipped employees (allocations at no less than 10% of gross receipts per tipped employee rather than 8%), which is a reporting requirement now required only of restaurants with at least 10 employees.
Senate Proposal	Preserves current tax treatment.
Work Opportunity Tax Credit ("WOTC")	
Current Law	Employers may claim a tax credit equal to 40% of qualified first-year wages for employees belonging to nine at-risk targeted groups.
House Bill	Repeals tax WOTC credit for employees who begin work after 2017.
Senate Proposal	Preserves current tax status.

Although the nature of these changes is unsettled, employers should begin to prepare for impending change by taking the following steps:

- Communicate the possibility of these changes to your employees during the open enrollment process. For example, indicate in open enrollment materials that all tax-favored benefits are subject to change based on pending tax reform legislation.
- Review the definition of "compensation" in your qualified retirement plans. Many employers currently include fringe benefits that are taxable to employees as "compensation." The proposed changes would cause many fringe benefits that were previously not taxable to become taxable. If employers do not amend their plans to exclude specific sources of taxable compensation, they may be required to make increased employer contributions to their qualified retirement plans based on the newly includable sources of compensation.

- If you have employees in cities and states that require employers to provide some form of commuter benefit, you may be required to continue to facilitate transportation fringe benefits; consider the potential additional cost of compliance.
- When a final law is passed, contact the Executive Compensation and Benefits Team at Pillsbury for guidance on how to comply with the changes.

For a summary of changes contemplated by the House Bill and the Senate Proposal that relate to executive and equity compensation, see our alert "[**Tax Reform: The Shifting Landscape of Executive and Equity Compensation.**](#)"

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1 Codifies the current 35% excise tax on all HSA contributions made by an employer during a plan year if the employer does not make "comparable contributions" equal to the same dollar amount or the same percentage of the HDHP deductible plan coverage for every eligible employee in the same category of employment and category of coverage.

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