GROOM
LAW GROUP
CHARTERED

BENEFITS BRIEF

November 3, 2017 www.groom.com

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Kimberly M. Boberg
kboberg@groom.com
(202) 861-2606

Elizabeth T. Dold
edold@groom.com
(202) 861-5406

William P. Fogleman
wfogleman@groom.com
(202) 861-6619

Diana A. Hodges
dhodges@groom.com
(202) 861-6650

Daniel L. Hogans
dhogans@groom.com
(202) 861-5414

Michael P. Kreps
mkreps@groom.com
(202) 861-5415

Jeffrey W. Kroh
jkroh@groom.com
(202) 861-5428

David N. Levine
Dlevine@groom.com
(202) 861-5436

Rachel Leiser Levy
rlevy@groom.com
(202) 861-6613

Mark L. Lofgren
mlofgren@groom.com
(202) 861-6614

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

David W. Powell
dpowell@groom.com
(202) 861-6600

Kevin L. Walsh
kwalsh@groom.com
(202) 861-6645

Brigen L. Winters
bwinters@groom.com
(202) 861-6618

Jeff Witt
jwitt@groom.com
(202) 861-6651

House Tax Reform Bill Unveiled

After months of preparation, yesterday House Republican's unveiled the Tax Cuts and Jobs Act (the "House Bill"), the initial step in Congressional consideration of comprehensive tax reform legislation. If passed, the House Bill would provide for the most sweeping changes to the U.S. Tax Code since 1986. In addition to proposing reductions in individual and corporate tax rates, the House Bill proposes far-reaching changes to the taxation of executive and nonqualified deferred compensation and relatively minor changes to IRA and qualified retirement plan rules, clarifies that unrelated business income tax (UBIT) applies to state and local government plans, and changes the tax rules that apply to various types of fringe benefits provided to employees.

Notably, the House Bill does not contain changes to the tax incentives for retirement savings. The inclusion of limits on pre-tax contributions to 401(k) and other types of defined contribution plans through so-called "Rothification" had been under strong consideration for inclusion in the bill as a significant "revenue raiser" to offset the cost of individual rate cuts, but this provision was not included in the House Bill after the significant pushback by the Save Our Savings Coalition, an advocacy group founded and advised by Groom Law Group and Capital Counsel. For more information about the Coalition, visit SaveOurSavings.org.

As discussed below, we expect this language to change as the legislation winds its way through Congress. Below is a high level overview of where things stand today.

Where Things Stand

While Republican leaders have said that they would like to have tax reform complete by the end of the year, it remains to be seen whether they can accomplish that goal. House Republican leaders are hopeful that the House Bill can be passed by the House of Representatives before Thanksgiving, and the Ways and Means Committee has scheduled a mark-up to begin on Monday, November 6. Senate Republican leaders have indicated that a draft Senate tax reform bill could be released as early as next week (although this timing is likely to slip). Nevertheless, the path to passage and enactment remains difficult. Now that the text of the House Bill is public, proponents of key tax code provisions that are being limited or eliminated are already becoming more vocal in criticizing the House Bill, with some powerful groups (*e.g.*, the National Federation of Independent Business (NFIB) and National Association of Homebuilders (NAHB)) announcing their opposition.

Changes to the Retirement System

While not a primary revenue raiser, the House Bill raises some revenue based on changes to the retirement plan provisions, although most of the changes are participant-friendly. Below

we summarize the changes, which are generally proposed to be effective for tax years (or plan years) beginning after December 31, 2017.

- **IRA Conversions.** Under current law, individuals can recharacterize a contribution to a traditional IRA to a Roth IRA and vice versa, and recharacterize a conversion of a traditional IRA to a Roth IRA. Under the House Bill, individuals would no longer be able to change the tax treatment of an IRA.

- **Minimum Age for In Service Distributions from Retirement Plans.** Currently, under some types of tax-favored plans individuals cannot take in-service distributions until they are age 62 (and in some cases 70-1/2). The House Bill would lower the age for in-service distributions in those plans to age 59-1/2.

- **Hardship Distributions.** The House Bill would direct the IRS to issue regulations permitting individuals who have taken a hardship distribution to continue contributing to their retirement accounts. Additionally, the House Bill would extend hardship distributions to amounts not previously permitted: QNECs, QMACs, and post-1/1/1989 earnings (which would include safe harbor plan contributions). It would also eliminate the requirement to take out plan loans prior to a hardship distribution.

- **Extended Rollover Period for Plan Loans.** The House Bill would extend the deadline to avoid having a plan loan be treated as a taxable distribution for individuals whose employment terminates while a plan loan exists (or in the event of plan termination). Under the bill, employees could roll over the loan balance to an IRA by the due date for filing their tax return (including extensions).

- **Modification of Non-Discrimination Rules.** The House Bill provides welcome relief to the ongoing question of how to address defined benefit plans where some grandfathered participants continue to receive benefits. Relief is provided from benefits, rights, and features nondiscrimination testing and 401(a)(26) minimum participation requirements for such plans. The relief further covers defined contribution plans where make whole contributions are provided to compensate participants when defined benefit accruals are reduced or eliminated.

Changes to NQDC and Executive Compensation

The House Bill would radically change the rules and restrictions for executive compensation. The proposal effectively eliminates nonqualified deferred compensation plans as tools for tax planning available to executives and public companies alike and would significantly restrict or effectively eliminate common forms of long-term incentive compensation.

- **Nonqualified Deferred Compensation.** The House Bill restricts future deferrals under nonqualified programs and would also cause existing deferred amounts to be includible in income by no later than 2025. First, the House Bill would cause all nonqualified deferred compensation related to services performed after 2017, including amounts under tax-exempt employer 457(b) and 457(f) plans, and the related earnings to be taxed when it vests, rather than when it is paid. The only valid vesting condition recognized under the House Bill is the future performance of substantial services (i.e., non-competes and performance conditions will not defer taxation). Additionally, the House Bill includes all stock options and stock appreciation rights under this early income inclusion rule – which could drastically inhibit their use as a talent attraction and retention tool for all companies. This could be particularly problematic for start-up companies that use such arrangements to preserve precious cash reserves needed to grow their business. The House Bill also lacks a

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

© 2017 Groom Law Group, Chartered • 1701 Pennsylvania Ave NW • Washington, DC 20006. All rights reserved.

specific severance exception, which could trigger early taxation of severance amounts payable over time. Importantly, amounts of nonqualified deferred compensation attributable to services before 2018 will be taxed during the later of 2025 or the year of vesting. The House Bill would require the IRS to establish rules allowing employers to amend plans to conform to these changes without violating Code section 409A. These proposed changes have the effect of eliminating the opportunity for an executive of any company or organization to defer taxation of earned income outside of a tax-qualified retirement plan and would trigger income recognition for long-term incentives once a continuing service vesting condition lapses, effectively without regard to when the amounts are actually payable.

- **Deductibility of Excessive Employee Remuneration.** The House Bill would expand the definition of compensation for purposes of the $1 million deduction limit to include all remuneration paid for services by eliminating the performance-based compensation and commission exceptions for compensation paid to top executives at publicly traded companies. The House Bill would realign coverage of the limit with the SEC disclosure rules to include compensation paid to the company's principal financial officer in addition to the principal executive officer and other three most highly paid executives. In addition, if an individual is a covered employee for any tax year commencing after 2016, his or her compensation would remain subject to the deduction limit in subsequent tax years, even if he or she is no longer a covered employee or the amounts are paid to a beneficiary. All of these changes would be effective for tax years beginning after 2017 without a grandfather or transition period.

- **Excise Tax on Excessive Employee Remuneration for Tax-Exempt Organizations.** The House Bill would impose on a tax-exempt employer a 20% excise tax on compensation in excess of $1 million paid to any of its top five most highly compensated employees, as well as on payments contingent on separation from employment paid to a covered employee in excess of three times his prior average annual compensation. Similar to the $1 million deduction limit above, if an individual is a covered employee for any tax year commencing after 2016, the 20% excise tax rules would continue to apply in subsequent tax years, even if he or she is no longer a covered employee. Again, these changes would be effective for tax years beginning after 2017 without a grandfather or transition period.

Application of UBIT to State and Local Governmental Plans

Historically, many state and local governmental 401(a) plans have taken the position that, because income of the related trusts would generally be exempt from tax under Code section 115, such trusts are not subject to UBIT under Code section 511. While there is limited guidance addressing this position, to date, the IRS has not challenged plans on this point. Section 5001 of the House Bill would amend Code section 511 to specifically provide that an organization or trust exempt from taxation under Code section 501(a) (such as a 401(a) plan trust) will not be exempt from UBIT solely because it excludes amounts from gross income under another Code provision. Therefore, under Section 5001, state and local governmental plans would likely be subject to unrelated business income tax under Code section 511 regardless of the provisions of Code section 115 (or any other Code section under which a plan may claim tax-exemption). This provision would be effective for taxable years beginning after 2017.

Changes to Fringe Benefits

The House bill repeals the deductibility of certain fringe benefits, including transportation, entertainment, meals, and recreation. It also limits the exclusion for employer-provided housing and repeals the exclusion for employee achievement awards, dependent care assistance programs, reimbursement of qualified moving expenses, adoption

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

© 2017 Groom Law Group, Chartered • 1701 Pennsylvania Ave NW • Washington, DC 20006. All rights reserved.

assistance programs, and educational assistance programs, and repeals the deduction and exclusion for contributions to Archer MSAs.

* * *

We will continue to monitor legislative developments related to these issues and provide updates as tax reform legislation moves through Congress.

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

© 2017 Groom Law Group, Chartered • 1701 Pennsylvania Ave NW • Washington, DC 20006. All rights reserved.